Subject: Audit of the functioning of the management and control systems in place to avoid conflict of interest as required by Articles 72-75 and 125 of Regulation (EU) No 1303/2013 and Articles 60 and 72 of Regulation (EC) No 1083/2006

2007CZ161PO004 Enterprise and Innovation OP
2007CZ161PO006 Environment OP
2014CZ16RFOP001 Enterprise and Innovation for Competitiveness OP
2014CZ16M10P002 Environment OP
2007CZ05UP0001 Human Resources and Employment OP
2007CZ052PO001 Prague – Adaptability OP
2014CZ05M9OP001 Employment OP

Ref.: Audit No REGC414CZ0133 (to be used in all correspondence)

Member State Reply – Ares(2019)5522224 of 2 September 2019

Your Excellency,

I am writing to inform you that DG REGIO and DG EMPL have analysed the reply received from the national authorities as part of the contradictory procedure to the audit report referred to above.

As a result of our analysis, please find enclosed the final audit report setting out the Commission auditors’ final findings, conclusions and recommendations for the resulted required corrective actions.

The irregular expenditure detected during the audit and the proposed financial corrections are presented in Annex II to the audit report.

I request that you treat the enclosed final audit report as confidential until the follow up procedure set below has been brought to a final conclusion. When the whole or part of the report is transmitted to persons concerned by the audit to enable them to take the necessary actions, please ensure that the information set out in this paragraph accompanies the transmission.
The national authorities are invited to advise whether or not they accept the conclusions and to report on the implementation of the recommendations within 60 calendar days of the submission of the national language version of this final audit report.

Furthermore, the national authorities are requested, in their reply, to confirm that findings that have a financial impact on the EU budget exceeding €10,000 have been reported to OLAF in the IMS system for reporting irregularities and to provide the relevant references.

Yours faithfully,

(e-signed) Francisco MERCHAN-CANTOS (e-signed) Franck SÉBERT

p.o. Mark SCHELFHOUT, Acting director

Enclosures: Final audit report + annexes

cc.: Mr Marc Lemaître, Director General, DG Regional and Urban Policy
Mr Joost Korte, Director General, DG Employment, Social Affairs and Inclusion
Mr Jerzy Plewa, Director General, DG Agriculture and Rural Development
FINAL AUDIT REPORT
Audit No. REGC414CZ0133

ENQUIRY:
Enquiry Planning Memorandum Thematic Audit on the compliance of the management and control systems with the regulatory framework related to the measures to avoid conflict of interests

FUND(S):
ERDF, CF and ESF

MEMBER STATE:
Czech Republic

EUSF ASSISTANCE:
2007CZ161PO004 Enterprise and Innovation OP
2007CZ161PO006 Environment OP
2014CZ16RFOP001 Enterprise and Innovation for Competitiveness OP
2014CZ16M10P002 Environment OP
2007CZ05UP005 Human Resources and Employment OP
2007CZ052PO001 Prague – Adaptability OP
2014CZ05M9OP001 Employment OP

Authorities Audited:
Bodies involved in the process of managing and allocating EU funds

Horizontal bodies:
• ESIF Council (Rada pro ESI fondy)
• Council for the Common Strategic Framework (Rada pro fondy Společného strategického rámce)
• National Coordination Authority (Národní organ pro koordinaci)
• Management and Coordination Committee (Řídící a kontrolní výbor)
Managing authorities and intermediate bodies:

- Ministry of Labour and Social Affairs
- City of Prague
- Ministry of Industry and Trade
- Business and Investment Development Agency - CzechInvest (Agentura pro podporu podnikání a investic CzechInvest)
- Agency for Business and Innovations (Agentura pro podnikání a inovace)
- Ministry of Environment
- The State Environmental Fund of the Czech Republic (Státní fond životního prostředí České republiky)

Audit Authority

ADDRSEES OF THE REPORT: His Excellency Mr Jakub DÜRR
Ambassador Extraordinary and Plenipotentiary
Permanent Representative of the Czech Republic to the EU
Rue Caroly 15/Carolystraat 15,
1050 Bruxelles/Brussel, BELGIUM

DATE OF AUDIT: 8 January 2019 to 15 February 2019
DG/UNIT CHEF DE FILE: REGIO and EMPL
ASSOCIATED DG: AGRI
EXTERNAL FIRM: none
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ANNEX III: LIST OF SYSTEMIC ERRORS

ANNEX IV: LIST OF PROJECTS SELECTED FOR AUDIT OF KEY REQUIREMENT

ANNEX V: LIST OF PROJECTS SELECTED FOR AUDIT OF KEY REQUIREMENT

ANNEX VI: OPINION OF THE CZECH MINISTRY OF JUSTICE
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<th>Acronym</th>
<th>Description</th>
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<tr>
<td>AA</td>
<td>Audit authority</td>
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<tr>
<td>AC</td>
<td>Assessment criterion</td>
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<tr>
<td>CA</td>
<td>Certifying authority</td>
</tr>
<tr>
<td>CCI</td>
<td>Common Code for Identification</td>
</tr>
<tr>
<td>CF</td>
<td>Cohesion Fund</td>
</tr>
<tr>
<td>Conflict of Interests Act</td>
<td>Act No 159/2006 Coll., of 16 March 2006 on conflict of interests</td>
</tr>
<tr>
<td>CPV</td>
<td>Common public procurement vocabulary</td>
</tr>
<tr>
<td>ENV OP</td>
<td>Environment Operational Programme</td>
</tr>
<tr>
<td>ERDF</td>
<td>European Regional and Development Fund</td>
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<tr>
<td>ESF</td>
<td>European Social Fund</td>
</tr>
<tr>
<td>ESIF</td>
<td>European Structural and Investment Funds</td>
</tr>
<tr>
<td>IB</td>
<td>Intermediate Body</td>
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<tr>
<td>IB-SFZP</td>
<td>Intermediate Body - State Environmental Fund of the Czech Republic (Státní fond životního prostředí České republiky)</td>
</tr>
<tr>
<td>IB-CZIn</td>
<td>Intermediate Body - Business and Investment Development Agency - CzechInvest (Agentura pro podporu podnikání a investic CzechInvest)</td>
</tr>
<tr>
<td>IB-API</td>
<td>Intermediate Body - Agency for Business and Innovations (Agentura pro podnikání a inovace)</td>
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<tr>
<td>INTOSAI</td>
<td>International Organisation of Supreme Audit Institutions</td>
</tr>
<tr>
<td>KR</td>
<td>Key Requirement</td>
</tr>
<tr>
<td>MA</td>
<td>Managing authority</td>
</tr>
<tr>
<td>MA EIC</td>
<td>Managing authority for Operational Programme Enterprise and Innovation for Competitiveness 2014 - 2020</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Description</td>
</tr>
<tr>
<td>--------------</td>
<td>-------------</td>
</tr>
<tr>
<td>MA EI</td>
<td>Managing authority for Operational Programme Enterprise and Innovation 2007 - 2013</td>
</tr>
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<td>MC</td>
<td>Monitoring Committee</td>
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<tr>
<td>MCS</td>
<td>Management and control system(s)</td>
</tr>
<tr>
<td>MoE</td>
<td>Ministry of Environment (<em>Ministerstvo životního prostředí</em>)</td>
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<tr>
<td>MoIT</td>
<td>Ministry of Industry and Trade (<em>Ministerstvo průmyslu a obchodu</em>)</td>
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<tr>
<td>MS2014+</td>
<td>National monitoring system for implementation of programmes in Czechia for 2014 -2020 programming period</td>
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<tr>
<td>OP</td>
<td>Operational Programme</td>
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<tr>
<td>OP HRE</td>
<td>Operational Programme Human Resources and Employment</td>
</tr>
<tr>
<td>OP EIC</td>
<td>Operational Programme Enterprise and Innovation for Competitiveness</td>
</tr>
<tr>
<td>OP PA</td>
<td>Operational Programme Prague - Adaptability</td>
</tr>
<tr>
<td>SME</td>
<td>Small and medium-sized enterprise</td>
</tr>
</tbody>
</table>
1. LEGAL BASIS

The legal basis for the co-ordinated audit mission is Article 75(1) and (2) of Regulation (EU) No 1303/2013, Article 72 of Council Regulation (EU) No 1083/2006.

2. OBJECTIVES

The main audit objectives of this mission were:

Audit objective 1

In relation to the grants signed with companies of the AGROPERT group between June 2011 and July 2018, obtain reasonable assurance that the management and control systems covering the above-mentioned programmes before the entry into force of Financial Regulation (EU, Euratom) No 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union were compliant with the regulatory framework and functioned effectively regarding the allocation of EU funds, from the approval of the programmes to the implementation phase, focusing specifically to measures in place to avoid conflict of interests;

Audit objective 2

To verify, through the review of a representative sample of operations, that the MCS functioned effectively as to KR 2 - Adequate selection of operations and KR 16 - Adequate audits of operations, as defined in the regulations applicable respectively for the 2007-2013 and 2014-2020 programming periods¹;

Audit objective 3

To verify, through the review of a representative sample of operations, that the MCS functioned effectively as to KR 4 - Adequate management verifications and KR 16 - Adequate audits of operations, as defined in the regulations applicable respectively for the 2007-2013 and 2014-2020 programming periods²;

Audit objective 4

To establish whether there is evidence of conflict of interest in the process of allocating EU funds to programmes or sectors that could favour operations introduced by companies of the AGROPERT group; and

Audit objective 5

To identify and assess changes in the structures, staffing and working procedure of the competent national authorities including the selection committees that might have influenced the attribution processes or the national controls and audits.


3. Audit Scope

The audit focused on:

- The verification of the compliance of the MCS with the applicable regulatory framework and its effective functioning as regards avoiding conflicts of interests;
- The review of the systems and procedures in place with regard to the above-mentioned KRs 2, 4 and 16 for ERDF, CF and ESF funds allocated to companies of the AGROFERT group under the 2007-2013 and 2014-2020 programming periods.
- A detailed testing of the selected samples of operations for which companies from the AGROFERT group and other possible companies were beneficiaries, at the premises of the concerned programme authorities and/or intermediate bodies; and
- The review of the work done by the audit authority, including system audits and audits of operations, related to these operations.

For ERDF/CF funds, 36 operations were selected for audit from a total of 98 operations for which AGROFERT group companies were granted ESF/ERDF/CF funding. 6 of these operations were added at a second phase and are treated as an exhaustive stratum. The list of the selected operations is at Annex IV. The audit population did not contain any operations for which the grants were awarded after 2 August 2018 (i.e. after the entry into force of the Financial Regulation 2018).

The table below shows an overview of the approved ERDF/CF funding (EU contribution) to the companies of the AGROFERT group, in CZK and in approximate amounts in EUR, based on information provided by the Czech authorities in November 2018:

<table>
<thead>
<tr>
<th>Prog. period</th>
<th>MA</th>
<th>Value sample (EU contribution) in CZK</th>
<th>Value population (EU contribution) in CZK</th>
<th>%</th>
<th>Number of operations in sample</th>
<th>Number of operations in the population</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007-2013</td>
<td>MoIT</td>
<td>291.344.453,00</td>
<td>416.025.203,00</td>
<td>70%</td>
<td>11</td>
<td>22</td>
<td>50%</td>
</tr>
<tr>
<td>2007-2013</td>
<td>MoE</td>
<td>684.273.007,00</td>
<td>799.839.868,45</td>
<td>86%</td>
<td>13</td>
<td>52</td>
<td>25%</td>
</tr>
<tr>
<td>2014-2020</td>
<td>MoIT</td>
<td>243.622.416,18</td>
<td>340.519.464,91</td>
<td>72%</td>
<td>10</td>
<td>22</td>
<td>45%</td>
</tr>
<tr>
<td>2014-2020</td>
<td>MoE</td>
<td>86.865.838,30</td>
<td>86.865.838,30</td>
<td>100%</td>
<td>2</td>
<td>2</td>
<td>100%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>1.306.105,714</td>
<td>1.643.250.374,7</td>
<td>79%</td>
<td>36</td>
<td>98</td>
<td>36%</td>
</tr>
</tbody>
</table>

For ESF funds, in total, three operations have been audited, i.e. two operations for the 2007-2013 programming period and one operation for the 2014-2020 programming-period. These three operations represent the entire population of ESF operations awarded to the AGROFERT group since 2012, as follows:

---

3 Indicative exchange rate used in this report: 1 EUR = 25,80 CZK
4 Based on the lists provided to REGIO, EMPL and AGRI the by the Czech authorities on 30 October 2018, of all operations for which AGROFERT group companies have received co-financing from ERDF/CF/ESF/BAFD in the 2007-2013 and 2014-2020 programming periods.
<table>
<thead>
<tr>
<th>Project No</th>
<th>Beneficiary</th>
<th>OP</th>
<th>Project value (CZK)</th>
<th>Award date</th>
</tr>
</thead>
<tbody>
<tr>
<td>16_043/0004636</td>
<td>Synthesis, a.s.</td>
<td>OP Employment</td>
<td>1,899,360.00</td>
<td>1/3/2017</td>
</tr>
<tr>
<td>94.00822</td>
<td>MAFRA, a.s.</td>
<td>OP HRE</td>
<td>4,021,162.60</td>
<td>20/5/2013</td>
</tr>
<tr>
<td>11.00/34415</td>
<td>ACOMWARE, s.r.o.</td>
<td>OP PA</td>
<td>753,924.70</td>
<td>21/3/2012</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Total</td>
<td>6,674,447.30</td>
<td></td>
</tr>
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</table>

The concerned ESF and ERDF/CF MAs were requested on 4 December 2018 by the Commission and accepted on 6 December 2018 to stop declaring expenditure to the Commission in relation to operations granted to the AGROFERT group companies. Therefore, the amounts in the tables above, represent the maximum grant value of the 101 operations (98+3) while the amounts already reimbursed by the EU budget for these operations amount to CZK 1,273,290,818 (approx. EUR 49,35 mio) and CZK 3,190,016 (approx. EUR 0,12 mio) for the ERDF and the ESF respectively.

3.1. Audit of common bodies involved in the process of managing and allocating EU funds

The audit of the common (horizontal) bodies was carried out jointly by EMPL, REGIO and AGRI on 8 – 9 January 2019 and 14 – 15 January 2019.

The audit took place at the level of the following common bodies involved in in the process of managing and allocating EU funds to policy priorities and operational programmes:

- ESIF Council (*Rada pro ESI fondy*);
- Council for the Common Strategic Framework (*Rada pro fondy Společného strategického rámce*);
- National Coordination Authority (*Národní organ pro koordinaci*); and
- Management and Coordination Committee (*Řídící a kontrolní výbor*).

The audit covered all aspects related to the process of management and allocation of EU funds, from the approval of the OPs to the implementation phase, for both programming periods, focusing on the involvement of Prime Minister Mr Babis and any perceived conflict of interest. The results, including the findings and recommendations of this part of the audit, are included in section 5.1 of this report.

3.2. Audit of the ERDF and CF projects granted to companies of the AGROFERT group

For ERDF and the CF, four OPs were covered (two per programming period), managed by two MAs, i.e. the Ministry of Environment (hereafter ‘MoE’) and the Ministry of Industry and Trade (hereafter ‘MoIT’) and the related intermediate bodies, i.e. the State Environmental Fund (hereafter ‘SFZP’), Business and Investment Development Agency – CzechInvest (hereafter ‘CZIn’) and the Agency for Business and Innovations (hereafter ‘API’). The audit took place at the premises of the managing authorities, intermediate bodies and the audit authority.

The audit work also included a review of the systems and procedures in place with regard to the key requirements mentioned in section 2 of this report, supplemented by detailed testing of a representative sample of operations.
Sample of operations related to KR 2 – Adequate selection of operations

The audit sample was drawn based on the EU contribution from the population of operations granted to the AGROFERT group companies in both the 2007-2013 and 2014-2020 programming periods by the MoE and the MoIT. The extrapolated results are also based on the EU contribution.

Given the small size of the population subject to audit, REGIO auditors applied a random selection method to draw their sample. The sampling method used was the Equal Probability – simple random sampling stratified per managing authority (i.e. 15 operations per managing authority) and programming period. 6 operations were added at a second phase, giving a total of 36 operations in the sample, and are treated as an exhaustive stratum.

The selected operations, by programming period and by operational programme, are listed in Annex IV.

Detail of the coverage:

For ERDF and CF, a representative sample of 36 operations was selected from the entire population of 98 operations of the AGROFERT group companies co-financed by the ERDF/CF from 2011 to 2018, in order to extrapolate the results to this population. The sample covers the managing authorities for both programming periods. Details of the audit coverage in value and in number of operations (per managing authority and per programming period) are provided in the table at point 3 above.

Sub-sample of operations related to KR 4 – Adequate management verifications

For assessing the proper functioning of KR 4, a sub-sample of 10 operations was drawn from the 36 selected operations for KR2. This sub-sample covered 5 operations per managing authority. The list of operations selected is attached in Annex V.

In addition, for the managing authority at the Ministry of Industry and Trade, REGIO auditors reviewed all tender procedures launched within the reviewed operations for the 2014-2020 programming period and verified the reasons for grant decision modifications.

The sample and sub-sample selected are representative by MA and by programming period and therefore provide a sound basis for extrapolating the conclusions on the adequate functioning of KR 2 and KR 4.

The results, including the findings and recommendations of this part of the audit are included in section 5.2 of this report.

Review of the work carried out by the Audit Authority

For assessing the proper functioning of KR 16, the audit focused on the audit work performed by the audit authority as required by Article 127 of Regulation (EC) No 1303/2013, concentrating on audits of operations.

The audit work consisted of desk review of the audit authority reports and working papers submitted to the Commission as well as on the spot visit which included verifying:

(i) the methodology of the audit authority in order to verify whether its’ methodology is in line with applicable regulations (namely the CPR), that it provides for the selection of a representative sample of operations to be audited and provides for sufficient coverage of all legality and regularity aspects of the operations, focusing on the detection of potential conflict of interests and potential indications of undue influence on audit work;
(ii) whether the audit authority’s methodology was correctly applied, the audit strategy was complied with and whether there was evidence of any interference regarding the audit strategy and its implementation;

(iii) a sample of the audit authority’s working papers (checklists), in relation to detecting and preventing conflicts of interests with regard to project selection and management verifications;

(iv) the functioning of the new tool launched in January 2019 for checking ownership structure of beneficiaries by the audit authority and all managing authorities.

3.3. Audit of the ESF projects granted to companies of the AGROFERT group

For the ESF, the audit covered three OPs (two for the programming period 2007-2013 and one for the programming period 2014-2020) and two managing authorities – the Ministry of Labour and Social Affairs and the City of Prague. The audit took place at the premises of the managing authorities and at the level of one beneficiary.

The audit covered all aspects related to the process of management of EU funds, from the approval of the ESF OPs to the implementation phase and for both programming periods 2007-2013 and 2014-2020.

The audit work covered a review of the systems and procedures in place with regard to the abovementioned key requirements in the scope of the audit, including detailed tests on all ESF operations awarded to the AGROFERT group.

Sample of operations related to KR 2 and KR 4

In total, three operations have been audited by EMPL, i.e. two operations for the 2007-2013 programming period and one operation for the 2014-2020 programming-period. These three operations represent the entire population of ESF operations awarded to the AGROFERT group since 2012. Details of the audit coverage in value of operations are provided in the table at point 3 above.

The results, including the findings and recommendations of this part of the audit, are included in section 5.3 of this report.

4. APPROACH AND WORK DONE

The audit work was carried out in accordance with the methodology set out in the Mission Planning Memorandum and with the Guidance for the Commission and Member States on a common methodology for the assessment of management and control systems in the Member States, including the assessment criteria6.

The audit was performed in line with ISSAI 4000 (compliance audit guidelines from INTOSAI)5. It involved collecting evidence prior to and during the on the spot missions, reviewing procedures and files, carrying out interviews and reviewing the selection process and management verifications related to the selected sample of operations.

After finalising the on-the-spot work on 15 February 2019, the EC auditors requested additional clarifications from the national authorities by letter (Ares(2019)1057359) of 20

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5 EGESIF_14-0010-final dated 18 December 2014

6 http://www.issai.org/media/(797,1033)/ISSAI_4000_E_Endorsement_version_june.pdf
February 2019. This letter suspended the legal deadline set in Article 75(2a) of Regulation (EU) No 1303/2013 until the requested information was partly submitted on 26 February 2019 (Ares(2019)3420031).

Additional information was requested on 4 March 2019, again suspending the deadline set in Article 75(2)(a) and the Member State reply was received on 14 March 2019 through Ares(2019)1698371.

Therefore, taking into account the two requests for additional information, the three-month reporting deadline of Article 75(2)(a) of the CPR was extended by 16 days and expires on 31 May 2019.
5. FINDINGS AND ACTIONS TO BE TAKEN/RECOMMENDATIONS

5.1. Common Bodies - Horizontal system findings

Finding 01
Assessment of the design and functioning of the management and control system in relation to conflict of interest

1. Legal basis as regards conflict of interests


Article 59(1)
Where the Commission implements the budget under shared management, implementation tasks shall be delegated to Member States. The Commission and the Member States shall respect the principles of sound financial management, transparency and non-discrimination and shall ensure the visibility of Union action when they manage Union funds. To this end, the Commission and the Member States shall fulfil their respective control and audit obligations and assume the resulting responsibilities laid down in this Regulation. Complementary provisions shall be laid down in sector-specific rules.

Article 32(3)
Effective internal control shall be based on best international practices and include, in particular, the following:

a) segregation of tasks;
b) an appropriate risk management and control strategy including control at recipient level;
c) avoidance of conflicts of interests;
d) adequate audit trails and data integrity in data systems;

f) procedures for monitoring of performance and for follow-up of identified internal control weaknesses and exceptions;

periodic assessment of the sound functioning of the internal control system.

Although no definition of conflict of interests is available for shared management, Article 57 provides the elements and criteria under which a conflict of interests should be considered as present:

(1) Financial actors and other persons involved in budget implementation and management, including acts preparatory thereto, audit or control shall not take any action which may bring their own interests into conflict with those of the Union. Where such a risk exists, the person in question shall refrain from such action and shall refer the matter to the authorising officer by delegation who shall confirm in writing whether a conflict of interests exists. The person in question shall also inform his or her hierarchical superior. Where a conflict of interests is found to exist, the person in question shall cease all activities in the matter. The authorising officer by delegation shall personally take any further appropriate action.

(2) For the purposes of paragraph 1, a conflict of interests exists where the impartial and objective exercise of the functions of a financial actor or other person, as referred to in
paragraph 1, is compromised for reasons involving family, emotional life, political or national affinity, economic interest or any other shared interest with a recipient.

(3) The Commission shall be empowered to adopt delegated acts in accordance with Article 210 setting out what is likely to constitute a conflict of interests together with the procedure to be followed in such cases.


Article 36(3)

3. Effective internal control shall be based on best international practices and include, in particular, the following elements:

(c) avoidance of conflict of interests;

Article 61

(1) Financial actors within the meaning of Chapter 4 of this Title and other persons, including national authorities at any level, involved in budget implementation under direct, indirect and shared management, including acts preparatory thereto, audit or control, shall not take any action which may bring their own interests into conflict with those of the Union. They shall also take appropriate measures to prevent a conflict of interests from arising in the functions under their responsibility and to address situations which may objectively be perceived as a conflict of interests.

(2) Where there is a risk of a conflict of interests involving a member of staff of a national authority, the person in question shall refer the matter to his or her hierarchical superior. Where such a risk exists for staff covered by the Staff Regulations, the person in question shall refer the matter to the relevant authorising officer by delegation. The relevant hierarchical superior or the authorising officer by delegation shall confirm in writing whether a conflict of interests is found to exist. Where a conflict of interests is found to exist, the appointing authority or the relevant national authority shall ensure that the person in question ceases all activity in the matter. The relevant authorising officer by delegation or the relevant national authority shall ensure that any further appropriate action is taken in accordance with the applicable law.

(3) For the purposes of paragraph 1, a conflict of interests exists where the impartial and objective exercise of the functions of a financial actor or other person, as referred to in paragraph 1, is compromised for reasons involving family, emotional life, political or national affinity, economic interest or any other direct or indirect personal interest.


Article 3(6)

'beneficial owner' means any natural person(s) who ultimately owns or controls the customer and/or the natural person(s) on whose behalf a transaction or activity is being conducted and includes at least:

b) in the case of trusts:

i) the settlor;
ii) the trustee(s);
iii) the protector, if any;
iv) the beneficiary, or where the individual benefiting from the legal arrangements or entity have yet to be determined, the class of persons in whose main interest the legal arrangements or entity is set up or operates;

v) any other natural person exercising ultimate control over the trust by means of direct or indirect ownership or by other means;


Article 65(1)

The eligibility of expenditure shall be determined on the basis of national rules, except where specific rules are laid down in, or on the basis of, this Regulation or the Fund-specific rules.

Act No 159/2006 Coll., of 16 March 2006 on conflict of interests

Article 2

(1) For the purposes of the Act, ‘public official’ means

a) deputy of the Chamber of Deputies of the Parliament of the Czech Republic;

... c) member of the government or head of another central administrative authority not headed by a member of the government.

...

Article 3 (1)

Public officials shall refrain from any conduct in which their personal interest may influence the performance of their function. ‘Personal interest’ means, for the purposes of this Act, any interest which enables a public official, a person close to a public official, a legal entity controlled by a public official or by a person close to a public official, to increase their assets or asset-related or other benefits, or to avoid the loss of asset-related or other benefits or advantages; this shall not apply where the benefit or interest is generally clear in relation to an unlimited number of addressees.

Article 4 (1) and (2)

(1) Public officials as referred to in Article 2(1)(c) to (m) may not

a) engage in business or another self-employed activity,

b) be a member of the statutory body or the management, supervisory or inspection body of a legal entity that engages in business (hereinafter ‘legal entity engaged in business’), unless specific legislation provides otherwise, or

c) be in a labour-law or similar relationship or in a service relationship other than the relationship in which they operate as a public official.

(2) The restrictions under Paragraph (1) shall not apply to the administration of the public official’s own assets or to activities of a scientific, pedagogical, publicity-related, literary, artistic or sporting nature, with the exception of business activities in these fields.

Article 4c (entry in force on 9 February 2017)

It is forbidden to provide a subsidy under the legislation governing budgetary rules or investment incentives under the legislation governing investment incentives to a commercial enterprise in which a public official as referred to in Article 2(1)(c) or the controlled entity of
such a public official owns a share representing a holding of at least 25% in the commercial enterprise.

**Act No 253/2008 Coll., of 5 June 2008 on selected measures against legitimisation of proceeds of crime and financing of terrorism**

Article 4(4)(c)

For the purpose of this Act, a beneficial owner shall mean a natural person having factual or legal possibility to realize directly or indirectly decisive influence in a legal person, trust or other legal arrangement without legal personality. It shall be deemed that under the conditions given in the first sentence the beneficial owner is:

[...]

c) for a foundation, institute, trust or other legal arrangement without legal personality a natural person or beneficial owner of a legal person, who is in a position of:

1. a founder,
2. a trustee,
3. a beneficiary,
4. a person in whose interests was the foundation, institute, trust or other legal arrangement without legal personality established or is functioning, if a beneficiary is not determined, and
5. a persons allowed to maintain supervision on administration of the foundation, institute, trust or other legal arrangement without legal personality.

2. Identified facts

(1) Since 26 October 2013, Mr Babiš has been a deputy in the Chamber of Deputies of the Parliament of the Czech Republic. Mr Babiš served as Minister for Finance and Deputy Prime Minister for Economy from 29 January 2014 to 24 May 2017. Since 6 December 2017 he has been Prime Minister.

The Prime Minister as the head of government provides the main policy orientation to the government, proposes members of the government to the President for appointment and can request the President to recall them. The government proposes the state budget and is also responsible for its implementation. Within limits laid down by law, the government therefore proposes public spending priorities and the allocation of funding to those priorities. The amount of public spending that is later reimbursed by ESI funds forms part of the revenue of the state budget.

The government can also dismiss senior civil servants responsible for EU funds based on the system set out in Article 17 of the Czech Act No 234/2014 Coll., on the Civil Service. For example, in January 2018 the government headed by Mr Babiš dismissed the Deputy Minister at the Ministry of Labour and Social Affairs, responsible for the section dealing with EU funds.

(2) Mr Babiš was, since 29 January 2014, a member of the Council for the Common Strategic Framework (Rada pro fondy Společného strategického rámce), which in December 2014 was transformed into the ESIF Council (Rada pro Evropské strukturální a investiční fondy). Both councils are expert and advisory bodies to the government on the coordination of assistance provided from the EU funds. Conclusions of the councils are the basis for further decision making by the ministers responsible further down the cascade for the implementation of EU funds.
(3) The audit authority is an entity within the Ministry of Finance reporting to the Deputy Minister of Finance.

(4) Mr Babiš was, during the period when he served as Minister for Finance and Deputy Prime Minister for Economy (from 29 January 2014 until 24 May 2017), the sole shareholder of the AGROFERT group. As the sole owner of the group, he had an economic interest in its success. Although not a direct member of the statutory, management or supervisory body, Mr Babiš as the sole shareholder exercised the functions of the General Meeting and was deciding in this function on the distribution of the profits and appointment and dismissal of the members of the (statutory, management and supervisory) bodies from the group.

During that period, the Czech Act No 159/2006 on Conflict of Interests prohibited a public official, a term that covers members of the government, from being engaged in any business activity or from exercising any other lucrative activity (Article 4(1) of the Act). However, the prohibition shall not apply to the administration of the person’s own assets (Article 4(2) of the Act).

Under Union law, a distinction is made between the mere fact of holding shares (even controlling shareholdings), which is not regarded in itself as an economic activity, and the actual carrying on of business, for example through the exercise of a controlling shareholdings in order to intervene in management. Such a distinction is relevant also in the interpretation of the Czech law. Therefore, it could be concluded that the shareholding of Mr Babiš in the AGROFERT group would be covered by the exception in Article 4(2) of the Czech Act No 159/2006 Coll. on conflict of interests only to the extent that he did not actually exercise control over the group by involving himself directly or indirectly in its management.

In this regard, the Commission services identified the following decision of Mr Babiš as the sole shareholder of the AGROFERT group exercising the function of the General Meeting:

- On 5 May 2014, Mr Babiš decided on the distribution of the profits of the company AGROFERT a.s. for the year 2013;
- On 23 January 2015, Mr Babiš decided to modify the Statute of the company AGROFERT a.s. (e.g. authority of the General Meeting, information flows towards the General Meeting, authority of the Board of Directors and Supervisory Board);
- On 24 June 2016, Mr Babiš decided to modify the Statute of the company AGROFERT, a.s (e.g. shares of the company, rights of the shareholders, authority of the General Meeting);
- On 28 July 2016, Mr Babiš decided to extend the period of one person in the Supervisory Board of the company AGROFERT a.s;
- On 16 December 2016, Mr Babiš decided to extend the period for seven persons in the Board of Directors and one person in the Supervisory Board and to modify the Statute of the company AGROFERT a.s. (e.g. shares of the company, rights of the shareholders, sole performance role of the General Meeting role, authority of the Board of Directors and Supervisory Board);

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7 Decision of the Supreme Administrative Court in the case 14 Kse 1/2017 – 131, points 23 and 35
• On 23 December 2016, Mr Babiš decided to dismiss one person from the Board of Directors of the company AGROFERT a.s.; and

This confirms that Mr Babiš was involved in the management of the AGROFERT group. Based on this assessment, the Commission services consider that this involvement fell under the prohibition in Article 4(1) of the Conflict of Interests Act and the exception in Article 4(2) did not apply. However, the Commission services understand that this article did not make an explicit link prohibiting granting public funds, including EU funds, to companies in which the public official was involved.

(5) Article 4c of the Conflict of Interest Act entered into force on 9 February 2017 and prohibited the award of a grant to a commercial enterprise in which a public official or a person controlled by a public official owns at least 25% of the shares of the commercial enterprise.

(6) On 1 February 2017, Mr Babiš established two Trust Funds (AB private trust I and AB private trust II). All companies of the AGROFERT group were transferred to these Trust Funds on 3 February 2017. The Articles of the Association show that Mr Babiš is the settlor and the sole beneficiary of these Trust Funds.

The AGROFERT group comprises approximately 900 companies, including branches throughout the Czech Republic, Slovakia, Hungary, Poland, the Netherlands, Russia and Germany. The AGROFERT group is one of the biggest companies in the Czech Republic involved mainly in agriculture, food processing and the chemical industry. It also owns two of the country’s top newspapers and TV and radio stations.

(7) The Articles of Association of the Trust Funds and contracts with the trustees confirm the following:

• The two main objectives of the Trust Funds are (i) the administration of the AGROFERT group and (ii) the protection of the interests of Mr Babiš;

• Mr Babiš established the Trust Funds (e.g. if the trustee...}

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does not protect the interests of Mr Babiš).

- Oversight of the administration of the Trust Funds is performed by the Board of Protectors. The Board of Protectors consists of 3 members appointed by Mr Babiš.

- The Family Protector is appointed by Mr Babiš (e.g. if the Protector does not protect the interests of Mr Babiš).

Finally, during the administration of the Trust Funds, Mr Babiš may receive any profit from the assets of the Trust Funds.

Article 3(6) of the Anti-Money Laundering Directive (Directive (EU) 2015/849 of the European Parliament and the Council of 20 May 2015) specifies that the beneficial owner in the case of trusts is the settlor, the trustee, the protector or the beneficiary. It means that Mr Babiš is the beneficial owner of the Trust Funds.

(8) Considering the above governance features, in particular that Mr Babiš has defined the objectives of the Trust Funds (notably the protection of his interests), set up them up and appointed all their actors, whom he can also dismiss, it can be assessed that he has a direct, as well as an indirect decisive influence over the Trust Funds. Based on this assessment, the Commission services consider that, through these Trust Funds, Mr Babiš indirectly controls the parent company of the AGROFERT group (AGROFERT a.s.).
As a consequence, the Commission services consider that Mr Babiš is subject to Article 4c of the Conflict of Interests Act. Therefore, the Commission services consider that all grants awarded to the AGROFERT group since 9 February 2017 are not compliant with the national law on conflict of interest prohibiting provision of a subsidy to such commercial enterprises and therefore with Article 65(1) of the CPR.

This conclusion seems to be supported by the opinion of the Czech Ministry of Justice (ministry responsible for the national Act on conflict of interest) from November 2018 (see Annex VI) which confirms:

*With regard to the foregoing, we have concluded that, in the case of trust funds, clearly the only situation in which application of the ban laid down in Article 4c of the Conflicts of Interests Act can be considered is a situation where, via a trust fund (and thus indirectly), a decisive influence is exercised over a commercial corporation (the controlled person) which itself owns a share representing a holding of at least 25% in a commercial enterprise that is to receive grants or investment incentives under the special legislation. As stated earlier, in an environment of control, influence may be exercised directly or indirectly, and thus even via another person or a non-entity (a trust fund, which itself may be the controlling person – for more, see above). However, before reaching a final conclusion on control, it is always necessary to examine, at all levels of control (if influence is being exercised indirectly), whether this influence is decisive in relation to the actions or other behaviour of the controlled person and is directly connected to it; the mere possibility of exercising such decisive influence will also suffice.*

At the same time, the analysis of the Ministry of Justice seems to imply that the prohibition in Article 4c of the Conflict of Interests Act applies only to the commercial enterprise concerned and not to the controlled person itself. This interpretation would mean that the abovementioned prohibition only applies to companies in which AGROFERT, a.s. company owns at least 25%, not to AGROFERT a.s itself. In the view of the Commission services, that interpretation would be overly formalistic.

The Commercial Corporations Act forms part of private law and governs primarily commercial corporations. This could be why the provisions on control mention only commercial corporations and not other entities (with or without legal personality), which could nevertheless also be ‘controlled’ but which are not primary object of the Act.

On the other hand, the Conflict of Interests Act forms part of public law and aims at avoiding a conflict of interests in all its forms. In this context, the term ‘controlled person’ in Article 4c of the Conflict of Interests Act should rather be understood more generally as an entity or a mechanism through which the control is exercised, not confined to the category of commercial corporations within the meaning of Commercial Corporations Act. Such an approach is also supported by the explanatory memorandum of the Act. Otherwise, it would be possible to by-pass the application of that provision simply by establishing a trust, while maintaining actual control over the concerned shares.

On the basis of the above, the Commission services consider that Article 4c also applies in a situation where the public official exercises decisive influence over a commercial corporation via a controlled entity that is not a commercial corporation and that does not need to have a legal personality, such as a trust fund.
Considering the above governance features, in particular that Mr Babiš has defined the objectives of the trust funds (notably the protection of his interests), set up their functioning and appointed all their actors, whom he may also dismiss, Mr Babiš currently exercises a decisive influence over the two trust funds.

Mr Babiš therefore controls the two trust funds and, through these trust funds, he also controls the AGROFERT group. Based on this assessment, the Commission services consider that this the AGROFERT group therefore falls under the prohibition in Article 4c of the Conflict of Interests Act. Therefore, companies in the group should not have been provided with subsidies and all related public grants, including ERDF, ESF and Cohesion Fund, awarded after 9 February 2017 are in breach of Article 4c of the Conflict of Interests Act and are considered irregular.

(10) In respect of the activities of the horizontal bodies (ESIF Council, National Coordination Body, government), the Commission services reviewed various documents (statutes, rules of procedures, minutes of meetings of the committees, supporting documents, decisions taken) related to the work of the above-mentioned common bodies since 2013. The Commission services also analysed the recordings of the meetings held by the ESIF council.

The analysis of these documents and recordings demonstrate that Mr Babiš applies influence over the decisions of these bodies, especially in the decision-making process concerning the allocation of funds between and/or within the operational programmes and in the approval of the measures for the redesign/improvement of the management and control systems of these programmes. Therefore, the management and control system in place did not prevent the allocation of EU funds being affected by conflict of interests, in particular the allocation of EU funds to programmes or sectors that could favour operations introduced by companies of the AGROFERT group. Under EU law, the Czech authorities had an obligation to ensure effective control systems to avoid conflict of interests. The decisions taken by the common bodies have been endorsed at the level of the government.

(11) The personal and/or economic interest of Mr Babiš can be demonstrated by the following decisions taken in relation to EU funds and from which the AGROFERT group benefited directly or indirectly:

- The National Coordination Authority carries out a risk analysis, identifying the risk of low absorption or lack of absorption of EU Funds by the Operational Programmes. The ESIF Council and the government approved the corrective measures (actions) to be taken by the MAs (e.g. internal re-allocation, increase of the limits in the call for projects, widening of the range of eligible expenditure). This resulted in an increase of the maximum allocation of funds for large companies for the OP Environment and OP Enterprise and Innovation for Competitiveness. The Commission auditors noted that large companies, including some from the AGROFERT group received funding under the programmes;

- In July 2016, a transfer of CZK 2 billion (approx. €78Mio) from the OP Transport to the OP Environment was discussed at the level of the ESIF Council. It should be noted that the OP Transport was already at that time one of the better performing OPs in terms of absorption, while the OP Environment had difficulties meeting the N+3 threshold and hence is at an increased risk of de-commitment. The Ministry

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8 Exchange rate of 25.80 CZK/EUR.
of Transport as the MA of the OP Transport opposed this shift of funding during inter-governmental consultations. The arguments raised were however not accepted and the re-allocation of the funds to the OP Environment was approved by the ESIF Council and the Government. Moreover, this transfer proposed by the National Coordination Authority suggested dividing the funds between two measures (sewage systems and air quality improvement in a 50/50 ratio). The Minister for Environment, who is a former chief executive officer of an AGROFERT group company, insisted on a different division between the two measures (sewage systems – 25% and air quality improvement – 75%). These re-allocations favoured the chemical industry sector which, in the Czech Republic, is dominated by AGROFERT group companies.

(12) The principle and the general obligation on avoidance of conflict of interests in shared management refers to all persons involved in the implementation and management of the EU budget. Therefore, it can be concluded that Mr Babiš has been involved in the implementation of the EU budget in the Czech Republic in the meaning of Article 59(1) read in conjunction with Article 32(3) of the Financial Regulation 2012\(^9\). Moreover, as of the entry into force of Article 61 of the Financial Regulation 2018\(^{10}\), a conflict of interest also exists in all those situations where the impartiality and objectivity of a decision is compromised by a personal interest held or entrusted to a given person. Such interest may be of a financial or non-financial nature and it may concern personal, family or economic relations.

Mr Babiš, is the beneficial owner of the AGROFERT group companies and since February 2017, of the two Trusts and has a direct economic interest in the success of the AGROFERT group in the meaning of (i) the definition given by Article 3(6) of Directive (EU) 2015/849 on Anti-Money Laundering, (ii) in the meaning of Article 59(1) read in conjunction with Article 32(3) of the Financial Regulation 2012, during the period in which he was a member of the Government.

3. Conclusions

a) Mr Babiš was actively involved in the implementation of the EU budget in the Czech Republic;

b) Mr Babiš is the beneficial owner of the AGROFERT group companies and since February 2017, of the two Trust Funds, which he fully controls and therefore has a direct economic interest in the success of the AGROFERT group; and

c) the impartial and objective exercise of Mr Babiš functions (as Prime Minister, the Chairman of the ESIF Council, Minister for Finance and Deputy Prime Minister for Economy) was compromised, due to the fact that he was involved in decisions which also affected the AGROFERT group.

On this basis, the Commission services’ conclusion is the following:

1) For the period before 9 February 2017: Mr Babis was engaged in business activity and the Czech management and control system did not ensure effective control including the avoidance of conflict of interest as required by Article 32(3) of the Financial


Regulation 2012 and with Article 4(1) of the Czech Act No 159/2006 on conflict of interests. In this regard, there was no evidence that any action has been taken at national level in respect of this non-compliance. However, the Commission services understand that this article did not make a specific link prohibiting granting of public funds, including EU funds, to companies in which the public official was involved. No financial corrections are therefore proposed by the Commission in respect of this breach of national rules or Article 32(3) of the Financial Regulation 2012.

2) For the period after 9 February 2017, in addition to the Czech authorities management and control systems continued non-compliance with Article 32(3) of the Financial Regulation of 2012 and with Article 4(1) of the Czech Act No 159/2006 on conflict of interests, 17 ERDF and ESF grants (ERDF 16, ESF 1) awarded to AGROFERT Group companies after that date did not comply with Article 4c of the Act No 159/2006. They are therefore irregular. A 100% financial correction should be applied to all related expenditure already declared to the Commission for these operations and the related public contribution from the programmes should also be cancelled. (See Annex III.b). The total value (EU contribution) of the 17 operations affected amounts to CZK 282,719,496, 27 (approx. EUR 10,96 mio) and CZK 949,580 (approx. EUR 36.809) for the ERDF and the ESF respectively.

3) For the period after the entry into force of Article 61 Regulation (EU, Euratom) 1046/2018, the deficiency of the management and control system as regards avoidance of conflict of interest continues to exist and in addition needs to ensure compliance with Article 36 (3) and Article 61 of Regulation (EU, Euratom) 1046/2018. Equally, funding awarded in breach of Article 4c of the Conflict of Interests Act is irregular and a 100% financial correction should be applied.

The Commission auditors did not identify any evidence of undue influence over the audit authority during the period when Mr Babiš was Minister for Finance.

In addition and separately from the issue of conflict of interests, the audit identified individual errors with a financial impact, demonstrating the existence of serious deficiencies in the functioning of the management and control systems for both periods 2007-2013 and 2014-2020 (See sections 5.2 and 5.3).

**Action to be taken / recommendation**

**Recommendations**

The managing authorities for the respective operational programmes are requested to:

(a) Apply a 100% financial correction in respect of all expenditure declared for the 17 operations identified as being in breach of Article 4c of Act No 159/2006 and cancel the related public contribution from the programmes;

(b) Verify all grants awarded on or after 9 February 2017 for all concerned 2014-2020 operational programmes (i.e. the Environment OP, the Enterprise and Innovation for Competitiveness OP and the ESF OPs) to ensure that they were awarded in compliance with Article 4c of Act No 159/2006 and from 2 August 2018, Article 61 of the Financial Regulation 2018, as concerns possible conflict of interests situations that may have affected grants awarded to any beneficiary. Financial corrections and cancellation of the related public contribution should be implemented for any irregular operations identified by this verification.
(c) In line with the obligation under Article 36 (3) of Regulation (EU, Euratom) 1046/2018, improve the management and control systems in place to identify any cases of non-compliance with Article 4 (1) and 4c of Act No 159/2006 or Article 61 of the Financial Regulation 2018 to ensure that no further grants are awarded in breach the rules on conflict of interests.

(d) Advise of any actions taken or proposed to be taken for the non-compliance of Mr Babiš with Articles 4(1) and 4c of the Conflict of Interests Act.

Importance: Critical

Body responsible: MAs/CA

Deadline for implementation: 2 months

Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

B) The interpretation of Article 4c of the Conflict of Interests Act put forward by the Commission is incorrect

[16] If we accept that Article 4c of the Conflict of Interests Act is applicable in this case, it does not alter the fact that the interpretation of the provision put forward by the Commission, and its application to the case in question, are incorrect.

[17] The prohibition contained in Article 4c of the Conflict of Interests Act affects, according to its wording, ‘a commercial company in which a public official referred to in Article 2(1)(c) or an entity that s/he controls owns at least a 25 % share’ (emphasis added).

[18] Contrary to the Commission’s finding in the draft audit report, a trust fund cannot be regarded as an entity controlled by a public official as referred to in Article 2(1)(c) of the Conflict of Interests Act, by means of which the official would control a share representing at least 25 % of a partner’s participation in the commercial company, and the prohibition on awarding a grant within the meaning of this provision would thus apply.

[19] Firstly, a trust fund cannot by definition be a controlled entity within the meaning of Article 4c of the Conflict of Interests Act. The concept of a controlled entity is defined in Article 74(1) of the Business Corporations Act, whereby ‘A controlled entity is a business corporation controlled by a controlling entity’ (emphasis added). Under Article 1(1) of the Business Corporations Act, business corporations include commercial companies and cooperatives. Under Article 1(2) of the Act, commercial companies include unlimited partnerships and limited partnerships, limited-liability companies and joint-stock companies, as well as European Companies and European Economic Interest Groupings. As a trust fund is not a business corporation within the meaning of Czech law, it also cannot be a controlled entity within the meaning of Article 4c of the Conflict of Interests Act.

[20] The Commission states that the concept of ‘controlled entity’ within the meaning of Article 4c of the Conflict of Interests Act must be interpreted more broadly, and that a trust fund must also be regarded as a controlled entity within the meaning of this provision. However, this broader interpretation has no justification in the Czech legal system.

[21] The Czech Republic emphasises that the interpretation of concepts and institutes of Czech law must be based on methods of interpretation under Czech law. In the Czech legal
environment, if legislation does not contain its own definition, a meaning must be given to the concept by other legislation containing the definition. Whether, in this case, a definition enshrined in legislation under private law is used to interpret a concept contained in legislation under public law has no bearing. This generally follows, for example, from Article 40 of the Government's Legislative Rules, confirmed by the academic literature and in direct relation to the concept of 'controlled entity'.

[22] It is not true, as the Commission states, that the explanatory memorandum would give rise to a need for a broader interpretation of the concept in question. On the contrary, it follows from the legislative process that the concept of 'controlled entity' in the Conflict of Interests Act is consistent with the concept in the Business Corporations Act. The Commission's assertion that, in the absence of such a broad interpretation, it would be possible to circumvent the prohibition in question by means of a trust fund is contrary to the very nature of the institution, which is to prevent the possibility of such control by the founder (see below).

[23] Last but not least, it should be noted that in many places in the draft audit report the Commission confuses the meaning of the concept of 'controlled entity', which is clearly defined in Czech law, with the meaning of 'beneficial owner' contained in Directive 2015/849, i.e. a completely different concept in EU law pursuing different objectives.

[24] While it is true that the Czech Republic, further to the Commission's request, requires grant applicants to provide information concerning their beneficial owners together with their application, it has in the past had intensive communication with the Commission concerning the reason for requesting this information, which is still unclear given the absence of such a requirement in EU law; nor are the consequences to be drawn from those findings clear. In any event it should be noted that the requirement to substantiate information on beneficial owners does not, and never did, aim to ensure compliance with Article 4c of the Conflict of Interests Act, which makes no mention of the concept of 'beneficial owner'. Such an approach would have no basis in national or EU law.

[25] Moreover, the same conclusions can be drawn from the recent Decision of the Central Bohemian Regional Authority, which overturned the first-instance decision of the Černošice Municipal Authority concerning the offence allegedly committed by Mr Babiš as a public official in being the controlling entity of a company operating television broadcasting and publishing periodicals. The authority of first instance concluded, as did the Commission in the draft audit report, that control of the companies incorporated in the trust fund is exercised via the trust fund as the controlled entity. Nevertheless, the Central Bohemian Regional Authority, whose legal opinion is binding on the administrative authority of first instance, clearly stated that the interpretation of the concept of 'controlled entity' for the purposes of the Conflict of Interests Act must be based on the definitions contained in the Business Corporations Act, and therefore the trust fund cannot be a controlled entity within the meaning of the Conflict of Interests Act. At the same time, the Appellate Body confirmed

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11 'Legislation must be terminologically uniform. At the same time, there must be alignment with the terminology used in subsequent and related legislation of differing legal force. If a new legal term is required, it must be further specified in the legislation.'


that, for the purposes of interpreting the concept of ‘controlled entity’, it cannot be based on the concept of ‘beneficial owner’ within the meaning of legislation governing money laundering, since these are two completely different concepts.\textsuperscript{14}

[26] Secondly, Article 4c of the Conflict of Interests Act does not prohibit the award of a grant to any public official who owns any share of a commercial company which is to benefit from a grant, except where that share reaches a certain level (specifically at least 25% of a partner's participation in the commercial company). This is based on the premise that above a certain level of ownership interest, a public official would have sufficiently qualified influence on the operation of the commercial company to motivate him, within his duties as a public official, to attempt to influence the award of grants to the benefit of such a company and thus ensure his own benefit.

[27] It is clear from this that, by prohibiting the award of grants, the legislature wanted only to sanction a situation where, by means of an ownership interest, a public official could exercise sufficiently qualified influence on the operation of such a commercial company.

[28] In the light of this, the need to interpret the concept of ‘an entity that s/he controls’ within the meaning of Article 4c of the Conflict of Interests Act is logical.

[29] The aim referred to would clearly not correspond to an interpretation whereby, to comply with the concept of ‘controlled entity’, consideration would need to be given to any influence by a public official on a certain entity owning a share in a commercial company which is to benefit from a grant.

[30] As set out above, the purpose of Article 4c of the Conflict of Interests Act is to sanction only those situations where, by means of an ownership interest, a public official could exercise a degree of qualified influence on the operation of a commercial company which is to benefit from a grant. In the final analysis, this also corresponds to the ordinary meaning of the concept of ‘control’, which indicates a qualified (higher) degree of influence.

[31] This qualified degree of influence cannot be exercised in the case of a trust fund.

[32] The institution of the trust fund was intentionally designed in a way which a priori prevents the founder of the trust fund from controlling it in a manner covered by the concept of ‘an entity that s/he controls’ within the meaning of Article 4c of the Conflict of Interests Act.

[33] Under Article 1448 of the Civil Code, a trust fund is created by removing assets from the founder’s ownership and entrusting them to an administrator, and a trustee undertakes to hold and administer those assets; the creation of a trust fund gives rise to separate and independent ownership of the allocated assets. The trustee takes and administers the assets in his own name. A trust fund is therefore not the property of the founder or of a person to be paid from the fund (beneficiary).

[34] Under Article 1456 of the Civil Code, ‘[A] trustee is entitled to exercise full administration of the property in a trust’ (emphasis added).

[35] It is therefore clear that the founder of a trust fund, or the entity whose benefit the fund serves, does not control that fund; on the contrary, its administration is conferred exclusively on the trustee.

[36] In such a case, therefore, a public official who is the founder of a trust fund or an entity

\textsuperscript{14} Annex 1 to the Decision of the Central Bohemian Regional Authority of 20 March 2019. The decision in question was published on the internet once it became final, on the basis of a request under the Free Access to Information Act.
whose benefit the fund serves is precluded from controlling the fund within the meaning of Article 4c of the Conflict of Interests Act.

[37] Nothing here alters the fact that the founder of a trust fund may exercise any influence on the management of the trust fund. Such influence does not infringe the obligation conferred on the trustee under Article 1448 if of the Civil Code; even if the founder were to change the trustee under certain circumstances, nothing would alter the obligation on the new trustee to administer the trust fund independently. Such influence does not therefore a priori fulfill the concept of ‘control’ within the meaning of Article 4c of the Conflict of Interests Act, as described above.

[38] Thirdly, even if trust funds could generally be considered controlled entities within the meaning of Article 4c of the Conflict of Interests Act (which they are not), it would still be necessary to assess whether, in this case, the founder of the trust funds concerned, who is at the same time the beneficiary within the meaning of the statutes of those funds, can actually control them.

[39] Yet the draft audit report pays no attention to the basic provisions of the statutes of both the funds concerned, which prevent such influence.

[40] According to the statutes of both trust funds, their main objective is to ensure the administration of the commercial companies incorporated in the trust funds. In other words, the main objective of the funds concerned is to preclude the possibility of control by the beneficiary, in accordance with the objective of that legal institution as referred to above.

[41] The Commission deduces the possibility of control of the trust funds concerned mainly from the personal influence of the founder on the activity of both funds.

[42] However, this is very limited. The founder may not appoint a new trustee himself; that power lies with the Board of Protectors, or another trustee is determined directly. It is therefore clear that the founder has no direct influence on the replacement of the trust funds’ trustee, and therefore logically could not exercise a decisive or significant influence through the trustee on the discussions and activity of the trust funds.

[43] The founder’s personal influence on the Board of Protectors is similarly limited. It is therefore clear that the founder’s influence on the composition of the Board of Protectors is so limited that the founder could not intervene in the administration of the trust funds through the Board of Protectors, or through it exercise a decisive or significant influence on the discussions and activity of the trust funds.

[44] But above all, even if the founder had such influence on the fund’s staffing matters,
[45] It therefore follows from the above that control of the trust funds in question by the beneficiary is clearly excluded.

[46] The Commission’s considerations regarding possible control of the trust funds in question by the founder are therefore completely hypothetical. It also clearly follows from CJEU case law on the issue of conflicts of interest in the field of procurement that a conflict of interests cannot be merely hypothetical (judgment T-292/15 Vakakis kai Synergates v Commission EU:T:2019:84, paragraphs 99 and 100: ‘However, although, under Article 94 of the Financial Regulation, the candidates or tenderers who, at the time of the procedure for the award of a public contract, are in a situation of a conflict of interests are excluded from the award of that contract, that provision permits exclusion of a tenderer from a procedure for the award of a public contract only if the situation of a conflict of interests to which it refers is real and not hypothetical. Accordingly, a risk of a conflict of interests must actually be found to exist, following a specific assessment of the tender and the tenderer’s situation (see, to that effect, judgments of 3 March 2005, Fabricom, C-21/03 and C-34/03, EU:C:2005:127, paragraphs 32 to 36; of 19 May 2009, Assitur, C-538/07, EU:C:2009:317, paragraphs 26 to 30; and of 18 April 2007, Deloitte Business Advisory v Commission, T-193/05, EU:T:2007:107, paragraph 67).’ [...] Therefore, it is for the contracting authority to determine and verify the existence of a real risk of occurrence of practices capable of jeopardising transparency and distorting competition between tenderers and to allow the tenderer who risks being excluded from the procedure the possibility to demonstrate that, in its case, there is no real risk of such a conflict of interests (see, to that effect, judgments of 3 March 2005, Fabricom, C-21/03 and C-34/03, EU:C:2005:127, paragraphs 33 and 35; of 19 May 2009, Assitur, C-538/07, EU:C:2009:317, paragraph 30; and of 23 December 2009, Serramenti e Consorzio stabile edito, C-376/08, EU:C:2009:808, paragraph 39)’ (emphasis added).

[47] However, as the Czech Republic has shown above, in the case assessed here the real risk of a conflict of interests (or of control of the trust funds by their founder) is excluded. For the sake of completeness, we would add that the draft audit report sets out no specific facts indicating that, despite this legal prohibition, the founder actually controls the trust funds or commercial companies in question which are to benefit from a grant.

C) The method of use of Article 4c of the Conflict of Interests Act put forward by the Commission is incorrect

C.1 The draft audit report does not take into account the fact that, for part of the period for which a financial correction is proposed, Mr Babiš was not a public official within the meaning of Article 4c of the Conflict of Interests Act.

[48] The prohibition set out in Article 4c of the Conflict of Interests Act relates exclusively to public officials pursuant to Article 2(1)(c) of the Act, i.e. members of the government or heads of other central administrative authorities not headed by a member of the government. The prohibition covers ‘the award of a grant’, i.e. it is clear that this rule applies at the time a grant decision is made.

[49] Between 25 May 2017 and 6 December 2017, Mr Babiš was not a member of the government or the head of another central administrative authority not headed by a member of the government, i.e. he was not a public official within the meaning of Article 4c of the Conflict of Interests Act. Thus the award of a grant during this period could not lead to an infringement of the prohibition referred to in the relevant provision.

C.2 The draft audit report does not take into account the previous period for the application of
Article 4c of the Conflict of Interests Act

[50] Article II(1) of Act No 14/2017, which introduced Article 4c into the Conflict of Interests Act, contains a transitional provision under which ‘The prohibition referred to in Article 4c shall apply to grant award procedures or investment incentives launched after the entry into effect of this Act. Procedures launched prior to the date of entry into effect of this Act shall be concluded pursuant to the previous legislation.’

[51] For the purposes of the Conflict of Interests Act, the moment of launching the grant award procedure must be regarded as the launch date of the call for applications. The concept of ‘grant award procedure’ must be interpreted more broadly than as a procedure for a specific application, by also covering all the formal acts of the service provider preceding the submission of the application. Thus the call for applications represents an obligatory and formalised act\(^\text{15}\) by the grant provider in each grant award procedure defining the conditions under which the grant may be awarded. It is through this call that all the parameters of the grant award procedure are set up and made binding. Therefore, if Article 4c covers a situation where a public official could hypothetically provide a benefit to a commercial company controlled by him as part of his public duties, it must be applied when the call is launched (regardless of the fact that, as part of the award of grants from the ESI Funds, measures are introduced which in practical terms exclude the possibility of influencing the setting up of the call, as the methodology and criteria used for the selection of operations are in line with Article 110(2)(a) of the CPR approved by the Monitoring Committee, and the calls are approved under the relevant platforms of the Operational Programme concerned). As regards ensuring that the grant award procedure complies with the law, this must be based on the moment the call is launched.

[52] This is, moreover, confirmed by Article 14g of the Budgetary Rules Act, which governs the conduct of the grant award procedure and also includes, as part of the activities falling within the concept of ‘conducting the procedure’, activity consisting of launching the call.

[53] In this regard, the Czech Republic would point out that the concept of ‘launching the procedure’ within the meaning of the transitional provision is also a concept in Czech law which must be interpreted in the context of Czech law (see paragraph 21 above).

[54] A financial correction therefore cannot be applied to a project, the call for which was launched before Act No 14/2017 came into effect.

[55] In any event, even if the Commission disagrees that the day on which the call was launched must be considered as the launch of the grant award procedure within the meaning of the transitional provisions of the Conflict of Interests Act (which it does not), there is no dispute that such a procedure is launched no later than the submission of the grant application.

[56] In any event, therefore, projects for which the grant application was submitted prior to the entry into effect of Act No 14/2017 must be excluded from the proposed correction.

C.3 Projects to which the financial correction cannot be applied for the reasons given above

[57] The projects for which there could be no breach of Article 4c of the Conflict of Interests Act, because at the relevant time Mr Babiš was no a public official within the meaning of Article 4c of the Act, include the following:

\(^\text{15}\) See Article 14j of the Budgetary Rules Act and, mutatis mutandis, Article 10c of the Act on budgetary rules for regional budgets.
<table>
<thead>
<tr>
<th>Project number</th>
<th>Project name</th>
<th>Date of call</th>
</tr>
</thead>
<tbody>
<tr>
<td>CZ.01.3.10/0.0/0.0/0.16_061/0010455</td>
<td>Kostelecké uzeniny - Most comprehensive energy measures</td>
<td>11.11.2017</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0.16_061/0010507</td>
<td>Energy savings at the PRIMAGRA plant in Klatovy</td>
<td>13.9.2017</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0.16_061/0008384</td>
<td>Rationalisation of heat consumption for heating of buildings</td>
<td>3.7.2017</td>
</tr>
<tr>
<td>CZ.05.2.32/0.0/0.0/0.15_008/0001081</td>
<td>Greening of energy source, Wotan Forest, a.s. - Solnice</td>
<td>31.7.2017</td>
</tr>
<tr>
<td>CZ.05.3.24/0.0/0.0/0.16_044/0004552</td>
<td>Long-term environmental burden, NAVOS, Boršov (Kýjov)</td>
<td>30.8.2017</td>
</tr>
</tbody>
</table>

[58] The projects for which there could be no breach of Article 4c of the Conflict of Interests Act, because the call for applications was launched prior to the entry into effect of Act No 14/2017, include the following:

<table>
<thead>
<tr>
<th>Project number</th>
<th>Project name</th>
<th>Date of call</th>
</tr>
</thead>
<tbody>
<tr>
<td>CZ.01.1.02/0.0/0.0/0.15_019/0004384</td>
<td>Catalytic pressure processes in extremely corrosive environments</td>
<td>26.6.2015</td>
</tr>
<tr>
<td>CZ.01.1.02/0.0/0.0/0.15_019/0004431</td>
<td>Modern synthesis methods for future generics and newly developed medicinal products</td>
<td>26.6.2015</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0.15_010/0000435</td>
<td>Energy savings at the PENAM, a.s., plant in Klimentov</td>
<td>1.6.2015</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0.15_010/0000478</td>
<td>Energy savings at the PRIMAGRA plant in Mřín</td>
<td>1.6.2015</td>
</tr>
<tr>
<td>CZ.03.1.52/0.0/0.0/0.16_043/0004636</td>
<td>Synthesia - company training</td>
<td>15.6.2016</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0.16_061/0011011</td>
<td>Technologies to reduce energy performance in production, Ethanol Energy a.s.</td>
<td>28.11.2016</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0.16_061/0011139</td>
<td>Replacement of grain dryer for more energy-efficient technologies, Havlíčkův Brod</td>
<td>28.11.2016</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0.16_061/0011143</td>
<td>Replacement of grain dryer for more energy-efficient technologies, Chotěboř</td>
<td>28.11.2016</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0.16_16J61/0011152</td>
<td>Replacement of grain dryer for more energy-efficient technologies, CREA Ríkov</td>
<td>28.11.2016</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0.16_061/0011875</td>
<td>Replacement of grain dryer for more energy-efficient technologies, Dobřenice - Syrovátky</td>
<td>28.11.2016</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0.16_061/0011988</td>
<td>Replacement of grain dryer for more energy-efficient technologies, Jičín</td>
<td>28.11.2016</td>
</tr>
</tbody>
</table>
We would point out that in the case of the bottom line, the draft audit report gives the amount awarded for ‘Synthesia - company training’ as CZK 1.899.360, although after recalculation using the EUR monthly rate for March 2017 (grant awarded as of 1 March 2017) the amount is EUR 70.292. The draft audit report gives the incorrect amount of EUR 75.571; there was probably a recalculation using the current rate at the time of the audit.

[59] Even if the Commission disagrees that the day on which the call for applications was launched may be considered as the moment of the launch of the grant award procedure (which it does not), it is in any event the case that the submission of the grant application must be considered as the launch of the grant award procedure within the meaning of the transitional provisions of the Conflict of Interests Act. The projects for which there could in any event be no breach of Article 4c of the Conflict of Interests Act, because the grant application was submitted prior to the entry into effect of Act No 14/2017, include the following:

<table>
<thead>
<tr>
<th>Project number</th>
<th>Project name</th>
<th>Date of application</th>
</tr>
</thead>
<tbody>
<tr>
<td>CZ.01.1.02/0.0/0.0/15_019/0004384</td>
<td>Catalytic pressure processes in extremely corrosive environments</td>
<td>11.9.2015</td>
</tr>
<tr>
<td>CZ.01.1.02/0.0/0.0/15_019/0004431</td>
<td>Modern synthesis methods for future generics and newly developed medicinal products</td>
<td>18.9.2015</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/15_010/0006435</td>
<td>Energy savings at the PENAM, a.s., plant in Klimentov</td>
<td>12.6.2015</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/15_010/0000478</td>
<td>Energy savings at the PRIMA GRA plant in Milin</td>
<td>15.6.2015</td>
</tr>
<tr>
<td>CZ.03.1.52/0.0/0.0/16 043/0004636</td>
<td>Synthesia - company training</td>
<td>29.8.2016</td>
</tr>
</tbody>
</table>

C.4 Conclusion

It follows from the above that, of the 17 projects in which the Commission finds a possible breach of Article 4c of the Conflict of Interests Act and requests a 100% financial correction, there can be no breach in 16 of those projects for the reasons set out above. The proposed correction cannot therefore be applied to those projects. To eliminate any doubt, the CR would add that in the case of the remaining project, ‘CZ.01.1.02/0.0/17 109/0011122 - Innovation technologies, production of mixtures for the preparation of sulphur fertilisers’, it disagrees with the financial correction, in particular for the reasons set out under B) in this section of the document.

Part 2 - Comments to the identified facts point (1)

[60] The Commission states that the government can dismiss senior civil servants responsible for EU funds, citing that in January 2018 the government headed by Mr Babiš dismissed the Deputy Minister at the Ministry of Labour and Social Affairs responsible for the section dealing with EU funds. In this connection it asserts that the Prime Minister provides the main policy orientation to the government, proposes members of the government to the President for appointment and can request the President to recall them.

[61] We have the following comments to make in response to the above: First of all, it needs to be pointed out that the government as such does not, as the Commission asserts, directly appoint deputy ministers, but decides on the establishment plan for civil service posts. The process of determining the establishment plan (‘systematisations’) is laid down in the Civil
Service Act, pursuant to Article 17 of which the Ministry of the Interior, acting on proposals from civil service bodies, develops a draft establishment plan which must be based on binding rules on the organisation of civil service bodies so as to ensure the proper exercise of their powers.

[62] The decision on the establishment plan is taken by the cabinet, as provided for in Article 76 of the Czech Constitution. In order for the government resolution to be adopted, an absolute majority of all members of the cabinet is required, and therefore - in terms of voting - the prime minister’s role is identical to that of any minister.

[63] The establishment plan adopted may result in the abolition of the post to which a civil servant was assigned. In the case of the head of a body whose post has been abolished, he/she is removed from that post not by the government but by the relevant civil service body. Where an establishment plan post is abolished, the ideal and most frequent solution is for the civil servant to be transferred to another post, as provided for in Article 61(1)(b) or (c) of the Civil Service Act. If no suitable post is vacant, the civil servant concerned is removed from service for up to 6 months. Throughout this period, the civil servant may be transferred to another suitable post, should one exist. If there is no vacant suitable post available, the civil servant’s service is terminated at the end of the six-month period, as provided for in Article 72(1) of the Civil Service Act. Termination of service (or transfer to another post or removal from service) is subject to administrative proceedings providing for the lodging of an appeal, which is examined by the hierarchically superior civil service body, and for subsequent judicial review of the decisions issued as part of the administrative proceedings.

[64] In the case of the Ministry of Labour and Social Affairs cited by the Commission, the government approved the 2018 establishment plan for civil servants and other employees by Resolution No 737 of 23 October 2017, as amended by Resolutions Nos 821 of 29 November 2017, 874 of 6 December 2017 and 895 of 22 December 2017, effective as from 1 January 2018. This establishment plan reduced the number of divisions from the original nine to seven and grouped together a number of lower-ranking organisational units. The material considered by the government also set out the reasons for the proposed establishment plan. The main benefits of the proposed changes were that they made individual processes more efficient and simplified their management, taking into account the logical connection between neighbouring portfolios. The portfolios of the abolished divisions for economic affairs and for European funds were attached to two newly created divisions: the Economic Affairs and ICT division and the European Funds division. This was necessary in order to eliminate management and financial control problems and risks that stemmed from the linking of economic portfolios (including management of the Ministry’s budget) with the European funds portfolio. The change also hived off responsibility for activities performed, which was the foremost essential requirement for eliminating management and financial control risks. The separation was also a response to Supreme Audit Office Finding No 16/29, which drew attention to systemic risks in relation to the keeping of the Ministry’s accounts and the need to implement a number of remedial measures in this area.

[65] It is clear from the above that the action taken in this regard was regular and fully in line with the Civil Service Act. What is more, the Commission called for the adoption of this legislation as a condition for receiving funds for the current programming period. The Civil Service Act has thus been brought into line with the Commissions requirements.

In view of the above, we request that the Commission remove this point from its findings.
Part 2 – Comments to the identified facts point (2)

[66] The Commission asserts that Mr Babíš was, since 29 January 2014, a member of the Council for the Common Strategic Framework, which in December 2014 was transformed into the ESIF Council. Both councils are expert and advisory bodies to the government on the coordination of assistance provided from the EU funds. The Councils’ conclusions are the basis for further decision making by the ministers responsible further down the cascade for the implementation of EU funds.

[67] Please refer to point 13 of these comments regarding Mr Babíš’s activities in the ESIF Council following on from the correspondence with Commissioner [REDACTED]. We also wish to add the following comments:

[68] It is not true, as the Commission argues, that the ESIF Council’s conclusions form the basis for subsequent decisions by ministers responsible for the implementation of EU funding: they serve merely as reference documents for the government’s deliberations on this subject. It is the relevant MAs that implement the programmes. The government may - but does not have to - take account of the ESIF Council’s recommendations or proposals. The final decision on such issues therefore always rests with the government as the collective supreme executive body.

[69] The minutes of the ESIF Council’s deliberations at a working level, including the conclusions, constitute an expert basis for the deliberations of the ministerial-level ESIF Council which discusses this documentation and then makes a recommendation to the relevant department as to what is submitted to the government.

In view of the above, we request that the Commission remove this point from its findings.

Part 2 – Comments to the identified facts point (4)

[70] The Commission asserts that Mr Babíš was, during the period when he served as Minister for Finance (from 29 January 2014 until 24 May 2017), the sole shareholder of the AGROFERT group and that as such he exercised the functions of the General Meeting and decided on the distribution of the profits and the appointment and dismissal of the members of the group’s bodies. It mentions in this regard that during that period, Czech Act No 159/2006 on conflict of interests prohibited a public official from being engaged in any business activity or from exercising any other lucrative activity. The Commission concluded that Mr Babíš did in fact control AGROFERT and thus also engaged in business activity, merely by virtue of being the sole shareholder. It equates the holding of shares with de facto control. We would point out that Mr Babíš placed the AGROFERT group shares into trust funds on 3 February 2017 and thus ceased to be the sole shareholder in the AGROFERT group on that date. It is not true - as the Commission asserts - that Mr Babíš was the sole shareholder until 24 May 2017.

[71] We have the following comments to make in response to the above: The conclusion of the audit report in this respect is incorrect since, according to Czech legislation and case-law, the mere ownership of shares and administration thereof cannot be regarded as business activity. In fact, this is an exception permitted under Article 4(2) of the Conflict of Interests Act. This fact is also mentioned in the Supreme Administrative Court’s decision to which the Commission itself refers.\textsuperscript{16} Interpretation to the contrary is also inconsistent with the definition of business activity contained in Article 420 of the Civil Code.

\textsuperscript{16} Cf. Supreme Administrative Court Decision of 4 July 2017, ref. No 14 Kse 1/2017-126, points 34 and 35.
[72] The Commission does not provide any concrete facts whatsoever to support its conclusion. The activities which the Commission mentions perhaps as a way of substantiating its conclusion in fact constitute a list of acts that shareholders are required by law to perform; in other words, these were not arbitrary decisions by the sole shareholder.

[73] The Commission has not proved that Mr Babiš took steps that went beyond the limits of administering his own assets. The conclusion that Mr Babiš was engaged in business activity, or was de facto in control of AGROFERT, in the period in question cannot therefore be accepted.

We therefore request that the Commission remove this point from its findings.

Part 2 – Comments to the identified facts points (5), (6), (7), (8) and (9)

[74] The Commission mentions that Mr Babiš established two Trust Funds on 1 February 2017, and that he is the settlor and sole beneficiary of both. It goes on to refer to the articles of association of the two Trust Funds (AB private trust I and AB private trust II) and describes the role of the administrator, the board of protectors and Mr Babiš in these funds. Referring to Directive 2015/849, the Commission also asserts that Mr Babiš is the beneficial owner of the trust funds. It concludes that Mr Babiš has a direct as well as an indirect influence over the trust funds and through these trust funds indirectly controls the parent company of the AGROFERT group. It concludes that Mr Babiš is subject to Article 4c of the Conflict of Interests Act and therefore that all grants awarded to the AGROFERT group since 9 February 2017 are not compliant with the national law on conflict of interests or, therefore, with Article 65(1) of the Financial Regulation.

In this regard, we would refer to points 16-59 of these comments and request that the Commission remove these points from its conclusion.

Part 2 – Comments to the identified facts point (10)

[75] The Commission states that it had analysed the horizontal bodies’ documents and had concluded that Mr Babiš applies influence over the decisions of these bodies, especially in the decision-making process concerning the re-allocation of funds between and/or within the operational programmes and in the approval of the measures for the redesign/improvement of the management and control systems of these programmes. Therefore, the management and control system in place did not prevent the allocation of EU funds being affected by conflict of interests, in particular the allocation of EU funds to programmes or sectors that could favour operations introduced by companies of the AGROFERT group.

[76] Firstly, with regard to Mr Babiš’s activities in the ESIF Council following on from the correspondence with Commissioner [redacted], please refer to point 13 of these comments. We also wish to add the following comments:

[77] Secondly, as regards Mr Babiš’s exertion of influence over horizontal bodies’ activities generally, it needs to be pointed out for a start that the task of these bodies consists in the formal discussion, and possibly adoption, of certain documents which are, nevertheless, drawn up by other bodies over which Mr Babiš does not and cannot exert any influence. Moreover, this point mentions the analysis of documents and audio recordings only in general terms, without making it clear exactly where and how influence was exerted - the Commission cites only two specific cases in point 11, and these do not accord with the facts (see below).

We therefore request that the Commission remove this point from its findings.
Part 2 – Comments to the identified facts point (11)

[78] The Commission refers to decisions taken in relation to EU funds from which the AGROFERT groups benefited directly or indirectly and which, in the Commission’s view, demonstrate the personal and/or economic interest of Mr Babiš.

[79] Firstly, the Commission makes mention of the National Coordination Authority and the approval of corrective measures by the ESIF Council and the government, which resulted in an increase of the limits in the calls for projects. It links these circumstances to the fact that AGROFERT group companies received funding under these programmes.

[80] We have the following comments to make in response to the above: It cannot be said that: only the ESIF Council and the government approve corrective measures to be adopted by the MA. The integrated risk management system (IRM5) is configured so as to be transparent, and the risk assessment for programmes is carried out in specialised working groups set up for the purpose of comprehensively assessing risks using group-based expert methods. The main decision-making body of the IRMS is the Risk Management Committee, which discusses identified risks and takes decisions on them and the proposed corrective measures by means of resolutions. It is composed of representatives of the Ministry of Regional Development’s National Coordination Authority, the PCA and the State Agricultural Intervention Fund, and a representative of the AA is invited to attend. After the Committee’s discussions, meetings take place with the MAs and an annual report is drawn up on the implementation of the Partnership Agreement, and this contains a description of the identified risks and the measures laid down.

[81] The government’s main task is not to identify risks and measures but to approve the annual report on the Partnership Agreement, the wording of which it does not change, and to adopt a resolution assigning tasks to individual ministers regarding the implementation of the measures laid down. Regardless of this, re-allocations of funding are approved by the monitoring committee for the OP in question set up in accordance with the rules of the general regulation.

[82] We are attaching as evidence of the above the Statutes of the Risk Management Committee and the Rules of Procedure of the Risk Management Committee.

[83] Secondly, the Commission cites the specific case of funds being transferred from OP Transport to OP Environment and the subsequent re-allocation of funds between sewerage measures and air quality improvement measures. The Commission links this situation to preference being given to the chemical industry in which companies of the AGROFERT group play a major role.

[84] In this connection, we wish to make the following comments: This funding transfer was proposed in response to the risk assessment for compliance with the N+3 rule at programme level and as a way of resolving EIA-related issues that had been the subject of lengthy discussions with the Commission in the context of OP Transport projects.

[85] Given the length of the process of assessing the impact of projects on the environment, and consequently of the legislative process for adopting new legislation, there was a risk that project approval and implementation deadlines could be significantly pushed back, which could have had a substantial adverse effect on the use of OP Transport funding.

[86] By 31 May 2016, just three aid applications under OP Transport had been registered, and these were for technical aid projects. There was a real risk of failing to comply with the n+3 rule in 2019 and the financial planning of funds under OP Transport in priority axis 2 had significant shortcomings (the forecast for the submission of requests for payment in 2017-
2019 indicated in the Strategic Implementation Plan differed by as much as CZK 2 billion in relation to the level of funding indicated in the absorption capacity analysis for OP Transport).

[87] As a result, the National Coordination Authority proposed that some funding be re-allocated from OP Transport to another programme. This re-allocation affected only the allocation to priority axis 2 ‘Road infrastructure in the TEN-T network, public infrastructure for clean mobility’, which was most affected by EIA-related issues. As priority axis 2 of OP Transport is co-financed from the Cohesion Fund, it was possible, under ESIF regulations, to transfer funding only to programmes/priority axes co-financed from the Cohesion Fund, i.e. to the relevant priority axes of OP Environment and OP Technical Assistance. However, as indicated in the approved re-allocation document, the National Coordination Authority did not recommend re-allocation to OP Technical Assistance, mainly because of the risks identified in the programme (at the time, suspension of follow-up projects in priority axis 2 was a major risk). OP Environment therefore proved to be the only suitable programme. The final amount re-allocated from OP Transport to OP Environment was CZK 73,760,000.

[88] In accordance with the CPR, re-allocation between programmes is possible only by requesting an amendment to the programming document. The request for amendment must be submitted for approval by the monitoring committees of the relevant OPs, in this case OP Transport and OP Environment. The relevant monitoring committees, in which programme partners are represented, approved the proposed amendments to the programming documents and the amendment request could therefore be submitted to the Commission for final approval.

[89] Monitoring committees are not obliged to adhere to the government’s decision and re-allocation cannot take place without their agreement. The government’s role in this process consists primarily in ensuring financing from the department seeking additional monies so that it is capable of providing funds for the pre-financing of new projects. If the opposite were true, a situation could arise where there were insufficient funds in the budget chapter concerned.

[90] It follows from the above that, in the system as it stands, the government does not have the final word as regards re-allocation, as was the case previously; cf. the minutes of the 20th session of the ROP SZ Monitoring Committee. A government resolution does not suffice if the monitoring committee does not approve the revision of a programme. The assumptions set out in the audit are therefore incorrect.

[91] It is therefore not obvious what the Commission based its conclusions on, as no example was cited to show that the government had intervened or amended the proposed re-allocation, as alleged by the Commission.

[92] The ministerial-level ESIF Council meeting minutes of 18 July 2016 show that Mr Babiš was not at all present at the meeting. They also show that the ESIF Council discussed - but did not approve - material relating to the proposed transfer of funds from OP Transport to OP Environment and that it called for the material to be submitted to the government in accordance with Article 18(9) of the Support for Regional Development Act and Article 2(2)(e) of the ESIF Council Statutes. The ESIF Council therefore cannot decide on the transfer of funds between programmes. Even though OP Environment proposed changing the funding split to 25:75 when the proposed re-allocation and allocation to individual projects were being prepared and discussed, it should be pointed out that, in the final version of the amendment to the programme, it is the variant originally proposed by the National Coordination Authority that was adopted, i.e. a 50:50 split.

[93] As regards the allocation of 25 % for sewerage and 75 % for air quality improvement,
it is necessary to take a long-term view of this issue. The table below illustrates changes in the equal split in Cohesion Fund funding between transport and the environment that was required in the 2004-2006 period, maintained in the 2007-2013 period and is also anticipated for instance in the proposal for a regulation for the 2021+ period.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR bn</td>
<td>%</td>
<td>EUR bn</td>
<td>%</td>
</tr>
<tr>
<td>OP Transport</td>
<td>0,47</td>
<td>50</td>
<td>4,60</td>
<td>53</td>
</tr>
<tr>
<td>OP Environ.</td>
<td>0,47</td>
<td>50</td>
<td>4,04</td>
<td>47</td>
</tr>
<tr>
<td>Total</td>
<td>0,94</td>
<td>100</td>
<td>8,64</td>
<td>100</td>
</tr>
</tbody>
</table>

The projected OP allocations for 2014-2020 were decided in 2014, when unfortunately OP Environment was affected by losing about CZK 7,5 bn from its 2007-2013 allocation for 2013 and risked further heavy losses in 2014 and 2015. Although it was possible to completely eliminate the projected loss by speeding up measures, the split in Cohesion Fund funding substantially in favour of OP Transport was maintained - even though the Commission itself pointed out during negotiations that it generally considered the reduction in the OP Environment allocation to be disproportionate. As a result, there was a small increase in the ERDF allocation for OP Environment, but there was no major change. This significantly affected the scope for apportioning funds to infrastructure measures for the environment, which include priority axis 1 (water) and priority axis 2 (air), as well as other measures relating to waste, historical environmental damage, or improving the energy performance of buildings.

<table>
<thead>
<tr>
<th>Funding from the Cohesion Fund (EUR bn)</th>
<th>2007-2013</th>
<th>2014-2020</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR bn</td>
<td>%</td>
</tr>
<tr>
<td>PA1 - water</td>
<td>1.72</td>
<td></td>
</tr>
<tr>
<td>PA2 - air</td>
<td>0.61</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>2.31</td>
<td></td>
</tr>
</tbody>
</table>

This table shows that significant priority was given to water management in the 2007-2013 period, in order to comply with the requirements of Directive 91/271. In the 2014-2020 period, air quality, which is also problematic under the relevant EU directives, is the main priority; nevertheless, the PA2 allocation also had to be reduced even though in relative terms by a smaller amount than the PA1 allocation. However, the table does not indicate that it was decided to assign the EUR 0,45 bn PA2 allocation for the 2014-2020 period primarily to new measures such as ‘boiler grants’ (approx. EUR 0,34 bn). Other air quality measures, where industrial businesses clearly predominate, are supported by other measures (e.g. air quality monitoring), which is why there was about EUR 0,12 bn remaining at the start of the 2014-2020 programming period, in other words about 20 % of the allocation compared with the 2007-2013 period. For the sake of completeness, existing allocations are included in the following table.
<table>
<thead>
<tr>
<th>OP Environment allocations 2014-2020 - PA2 (EUR bn)</th>
<th>CF/ERDF</th>
<th>Initial situation</th>
<th>Current situation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total allocation Priority axis 2</td>
<td>CF/ERDF</td>
<td>0,46</td>
<td>0,57</td>
</tr>
<tr>
<td>SC 2.1 - Replacement of household boilers</td>
<td>CF</td>
<td>0,34</td>
<td>0,38</td>
</tr>
<tr>
<td>SC 2.2 - Reduction of industrial emissions</td>
<td>CF</td>
<td>0,10</td>
<td>0,13</td>
</tr>
<tr>
<td>SC 2.3 - Air quality monitoring</td>
<td>CF</td>
<td>0,02</td>
<td>0,02</td>
</tr>
<tr>
<td>SC 2.4 - Reduction of average emissions (coal regions)*</td>
<td>ERDF</td>
<td>0</td>
<td>0,04</td>
</tr>
<tr>
<td><strong>Total for measures other than ‘boiler grants’</strong></td>
<td></td>
<td>0,12</td>
<td>0,19</td>
</tr>
</tbody>
</table>

*Coal regions - additional funds transferred to OP Environment from other OPs under the RESTART initiatives in 2018.*

[96] Thus, the Ministry of the Environment adopted decisions relating to air quality that focused mainly on households, at the expense of other measures where industrial businesses predominate. The reduction of the PA1 and PA2 allocation meant that demand substantially exceeded the available allocation - by more than 160% for PA1 and by almost 220% for PA2 in the area referred to above - as was demonstrated to the auditors during on-the-spots checks. Naturally, this situation did not go unchallenged and, under the partnership approach, which the Ministry of the Environment endeavours to adhere to, various stakeholders in the industrial sector repeatedly called on the Ministry to increase the allocation which, in their view, had been reduced entirely disproportionately.

[97] It also needs to be pointed out that the approximately 160% excess demand in PA1 was connected with a specific call, but other calls equating to an allocation of about CZK 5.65 bn were also planned (and implemented). Unsuccessful projects under the PA1 call in question could therefore apply for aid through other calls, the allocation for which significantly exceeded the level of aid requested for the unsuccessful projects. The approximately 220% excess demand for PA2 was the final situation, as there was no increase, because there were no more funds for another call in this field and no alternative national funds were available. The funds transferred from OP Transport were therefore used partly to satisfy demand from the project pool and partly for publishing another call. We therefore consider the Ministry of the Environment’s request to give preference to PA2 over PA1 to be totally justified [text possibly omitted] detailed knowledge of the programme that other stakeholders naturally did not have, and we do not consider it right or appropriate to brand the differing opinions expressed during the decision-making process, which are quite normal and part of an objective debate, to be an example of a conflict of interests. To illustrate this, please be aware that the additional PA2 call referred to above as a result of transferring funds from OP Transport was in actual fact published with an allocation of CZK 0.5 bn (about EUR 19 million), and that requests for aid worth about EUR 180 million were submitted. For this call, therefore, demand exceeded the available allocation by about 950%. It should be added that the increase in the allocation for PA2 - SO 2.2 (see table above) was accompanied by the creation of allocation PA2 - SO 2.4 (see table above) in 2018. This increase in allocation was highlighted by Commission representatives in connection with the RESTART initiative for coal regions. The majority of the aid provided from the SO2.2 allocation went to industrial businesses in coal regions. The Ministry of the Environment’s proposal to increase the PA2 allocation in 2016, which was turned down, was therefore also reflected to a large extent in the 2018 re-allocation, in which the Commission played a major positive role.

[98] In conclusion, it should be added with regard to the issue of the allocation increase for
OP Environment at the expense of OP Transport that we consider this approach to be justified by the successful acceleration of OP Environment 2007-2013 implementation in 2014-2015, which prevented the previously estimated loss of allocation to the programme of as much as CZK 15 bn.

[99] We would also stress that the Commission’s assertion that the funds were transferred with the aim of benefitting the chemical industry and hence also AGROFERT is absolutely erroneous. Private entities supported under PA2 come from other sectors: depending on the aid provided from the construction, extractive industries and heat production sectors, possibly along with some less investment-intensive projects from other sectors. No project has been identified that could be categorised under the chemical industry close to AGROFERT.

[100] It has also been established that, out of the total allocation of about CZK 3,5 bn for PA2 SO 2.2, to which CZK 1 bn of funds were transferred from OP Transport, there is just one project that belongs to the AGROFERT group. This is the Wotan Forest a.s. project with an approved allocation of CZK 61,5 million, i.e. less than 2 % of the total allocation as increased by the transfer from OP Transport.

What is more, this project was supported regardless of the re-allocation from OP Transport, as the support was approved by the selection panel on 24 August 2016, since the allocation had been released from three projects recommended for financing under call No 8 which the applicant ArcelorMittal requested on 30 June 2016 be transferred to the project pool (request for transfer to the project pool, proof of which was provided during an on-the-spot check). This was discussed by the selection panel in line with the procedures in force and other pooled - i.e. replacement - projects were approved for financing (24 in total, including the Wotan Forest project).

We therefore request that the Commission remove this point from its findings.

Part 2 – Comments to the identified facts point (12)

[102] The Commission is of the opinion that the principle and the general obligation on avoidance of conflict of interests in shared management refers to all persons involved in the implementation and management of the EU budget, so that it can be concluded that Mr Babiš was involved in the implementation of the EU budget in the Czech Republic. Mr Babiš is the beneficial owner of the AGROFERT group companies and of the two trust funds and had a direct economic interest in the success of the AGROFERT group during the period in which he was a member of the Government.

[103] With regard to the issue of the beneficial owner, influence over the trust funds and conflict of interests, we would refer you to points 16-59 of these comments. We also wish to add the following comments:

[104] The term ‘all persons’, as used by the Commission, is entirely lacking in precision. In any case, the Prime Minister cannot be regarded as a financial actor or a person involved in budget implementation within the meaning of Article 57 of the Financial Regulation 2012 or Article 61 of the Financial Regulation 2018. The Prime Minister is not without any doubt a financial actor within the meaning of Chapter 3 of the Financial Regulation 2012 or Chapter 4 of the Financial Regulation 2018. Nor can the Prime Minister be regarded as a person involved in budget implementation under direct, indirect and shared management, including acts preparatory thereto, and indeed audit or control. In the Czech Republic, these activities are entrusted to individual MAs, CA and AA.

[105] As stated in this context in recital 104 of the Financial Regulation 2018: 'The notion of
a ‘conflict of interests’ should be solely used for cases where a person or entity with responsibilities for budget implementation, audit or control, or an official or an agent of a Union institution or national authorities at any level, is in such a situation. Attempts to unduly influence an award procedure or obtain confidential information should be treated as grave professional misconduct which can lead to the rejection from the award procedure and/or exclusion from Union funds.’ (emphasis added). It is obvious that the Financial Regulation provisions in question relate to persons involved in budget implementation stricto sensu, i.e. in taking decisions on specific grants and projects, or persons directly performing control and audit activities. However, these provisions cannot be interpreted as covering per se all persons serving in the public administration, as the link between them and the provision of grants is extremely indirect. The aforementioned provisions should be interpreted rationally and applied functionally, in other words to persons directly involved in the award of grants, control and audit and proven to be capable of influencing such processes. They should not be applied to members of the government, who do not have the powers to do so. In other words, members of the government by definition deal with the main political orientations of government and are in no way involved in taking decisions on specific projects financed from EU funds. Therefore, the provisions of the Financial Regulations in question do not apply to members of the government.

[106] The above also applies to the issue of ‘preparing’ these activities within the meaning of Article 61 of the Financial Regulation 2018. Although the government, as the highest executive authority, and the ESIF Council, as its advisory body, have certain powers in the field of regional policy (especially in terms of determining its general orientation), those powers are only very indirectly linked to budget implementation, control and audit. Actual activities comprising preparation for budget implementation, control and audit within the meaning of the above provisions are performed by individual MAs, CA and AA.

In view of the above, we request that the Commission remove this point from its findings.

D) Conclusion

[107] The Czech management and control system is fully compliant with EU and national rules governing conflict of interests. Article 4c of the Conflict of Interests Act does not prohibit the provision of grants from the ESI Funds to AGROFERT group companies, so there are no grounds for requiring a financial correction or the adoption of other measures.

[108] In any case, if Article 4c of the Conflict of Interests Act did prohibit the provision of grants to AGROFERT group companies (which it does not), it could, owing to the timescales of the projects concerned, be applied to only one of the 17 audited projects.

[109] Moreover, in its draft audit report, the Commission bases itself on a whole range of inaccuracies that do not correspond to the actual situation. The Czech Republic therefore requests that the Commission remove from the draft audit report all the points referred to above, including both the findings and the conclusions and measures to be taken/recommendations.

Part 3 – Comments to the conclusions point (1)

[110] We do not agree with the Commission’s conclusion that rules for the management and control system for individual audited MAs were not in line with Article 32(3) of the Financial Regulation 2012 and Article 4(1) and (2) of the Conflict of Interests Act. However, as the Commission’s interpretations are not properly backed up and no specific conclusions are set out in the draft audit report, and because no financial correction in proposed on the
basis of its findings, we will not examine these findings more closely here, as there is nothing to respond to.

We request that this point be removed.

**Part 3 – Comments to the conclusions point (2)**

[111] In view of the analysis above (cf. points 57-59), we do not agree with the conclusion that, for the period after 9 February 2017, 17 ERDF and ESF grants were awarded to AGROFERT group companies in breach of Article 4c of the Conflict of Interests Act. Moreover, it should be mentioned that this conclusion is accompanied by a request to apply a 100% financial correction to all related expenditure already declared to the Commission, but this request is devoid of any justification that would warrant the application of the requested 100% financial correction. No argument has been presented as to why the proportionality principle was not applied to the size of the financial correction and, in particular, there is no description of the impact of the alleged circumstances on evaluation and selection, or on the implemented projects themselves. By analogy with point 21 [sic] of Commission Decision C(2019)3452 of 14 May 2019 on the application of financial corrections for non-compliance with the rules on public procurement, the actual impact of any conflict of interests should be demonstrated for each project before requesting a 100% financial correction. Otherwise no financial correction should be made. We therefore request that reasons be given for applying the 100% financial correction, or that the proportionality principle be applied, and that the actual impact of the conflict of interests be specified for each project for which a financial correction is required. Should no instance of a conflict of interests be found, we request that no financial correction be applied.

We therefore request that point 21 be removed.

**Part 3 – Comments to the conclusions point (3)**

[113] In view of the analysis above, we do not agree with the conclusion that Article 61 of the Financial Regulation 2018 could have been infringed in the period after 2 August 2018.

We request that point 31 be corrected accordingly, together with the associated recommendations, or that these recommendations be removed as the related findings have not been substantiated.

**Part 3 – Comments to the conclusions point (3) - Action to be taken/recommendation**

Re a) We consider that aid was provided to the two specified operations (projects) under OP Environment 2014-2020 in compliance with Article 4c of the Conflict of Interests Act, so there are no grounds for applying a 100% financial correction to the declared expenditure
and the related public contribution.

We reject this recommendation and request that it be removed.

Re b) We reject the request for verification of all projects in all the OPs concerned, as the analysis above has shown that the Commission did not identify projects which warrant such a request, and ask that it be removed.

Re c) The general arrangements governing an MA’s obligation to verify applicants’ or ESIF beneficiaries’ ownership structures are outlined in Chapters 2.1 and 5.1.1 of the Methodological Guideline on Financial Flows for Programmes Co-financed from the European Structural Funds, the Cohesion Fund and the European Maritime and Fisheries Fund for the 2014-2020 Programming Period, and described in more detail at individual OP level in the management documentation of the programme concerned. The Commission had never before called into question the set-up of the MCS described above.

We reject the request for improvement of management and control systems, as it has been demonstrated using the arguments set out above that none of the projects identified by the Commission are problematic with regard to Article 61 of the 2018 Financial Regulation.

Re d) In the light of the above, we reject the request for the taking of further actions in connection with Article 4(1) and 4c of the Conflict of Interests Act and ask that it be removed, as we consider it to be irrelevant. Moreover, we wish to add that the current system provides an adequate guarantee for the detection of any conflict of interests under these provisions.

Conclusion of the Commission services:

The finding is maintained.

The Commission services have analysed the Member State’s reply and maintain the position there has been a breach of the applicable Czech Conflict of Interests Act and therefore a breach of the Member State’s obligation stemming from the applicable EU law to put in place appropriate management and control systems capable of avoiding conflict of interests.

The Commission services provide the detailed analysis below.

I. Article 4c of the Czech Conflict of Interests Act

1.1. Notion of ‘control’ under the Czech law and whether a trust can be a ‘controlled person’

[Points 16 – 25 of the Member State’s reply]

The Czech authorities argue that a trust fund cannot be considered as a controlled person since the definition of a controlled person comes from the Czech Commercial Corporations Act and that definition applies to commercial corporations only.

The Commission services do not agree with the Member State’s argumentation for the following reasons.

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17 Article 63(1) and (4) of Regulation (EU, Euratom) 2018/1046 (the Financial Regulation) in conjunction with Article 36(3)(e) of that Regulation; Article 122 of Regulation (EU) No 1303/2013 (the Common Provisions Regulation) for ESI funds (except EAFRD) and Article 58(2) of Regulation (EU) No 1306/2013 (the CAP Horizontal Regulation) for EAFRD and EAGF
In the Czech legal environment, the term **control** is indirectly defined in Article 74(1) et seq. of the Commercial Corporations Act through the definitions of the ‘controlling entity’ and the ‘controlled entity’. The above provision defines a **controlling entity** as an entity that is able to exercise directly or indirectly decisive influence on a commercial corporation. **Controlled entity** is a commercial corporation controlled by a controlling entity. Commercial corporations are defined in Article 1(1) of the Commercial Corporations Act as cooperatives and companies. According to the above-cited provision of the Commercial Corporations Act, a trust is not a commercial corporation.

The above definition suggests that while any natural person or legal entity, corporation as well as any other person or entity (even without legal personality), including trusts, may generally be a controlling entity, only a commercial corporation may be a controlled entity as defined in the same provision.

The possibility of a trust fund to be a **controlling entity** is also supported by the fact that the law gives trust funds, albeit indirectly through the trustee, the ability to act which is basically an ability to control a third party. Given that, in accordance with Article 1448(3) of the Czech Civil Code, ‘rights to trust property are exercised by the trustee in his or her own name on behalf of the trust’, the trust has a real ability to control a third party through the trustee acting on behalf of the trust in the exercise of his or her position.

The Commercial Corporations Act does not expressly define whether control may be exercised de jure or de facto. However, this is clear from the nature of the matter. The legal fact that usually establishes control is the participation of the controlling entity in the controlled entity. In this way and through representation in the governing and supervisory bodies, the controlling entity is able to exercise decisive influence. In terms of actual influence, the ability to exercise decisive influence results from any significant event that means, de facto, the ability to exercise decisive influence.

According to the Czech legal theory, any control of other person is characterised by the following **general features of control**:

a) Long-term and rather continuous connection between the controlling and the controlled entities. That means that one-time, random or isolated influence (or, where appropriate, the ability to exercise such influence) on one or several decisions of the controlled entity by another entity (in which case it would be mere influence, not control over the other entity) is not control.

b) The influence on decision-making and actions of the controlled entity (or, where appropriate, the ability to exercise such influence) is major, decisive and or dominant. The intensity of the controlling entity’s influence is therefore potentially high. The mere possibility of exerting decisive influence in the controlled person is sufficient to fulfill the characteristics of control, the demonstration of the actual exercise of this influence is not necessary.

c) The influence (or, where appropriate, the potential influence) is directed not only towards managing or operating a business of the controlled entity. It may also concern internal relationships within the controlled entity. This is not limited to the mere implementation of company policies and conceptual business management. Control is exercised by as little as the real ability to intervene in the controlled entity’s operations.

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18 See to the same effect the opinion of the Czech Ministry of Justice of 30th November 2018 (ref. MSP-111/2018-OSZ-SP/1), p. 2
in individual situations or the ability to influence the actions and decision-making of the controlled entity.

d) Decisive influence may be exercised directly or indirectly, i.e. directly by the controlling entity or through any other persons.  

Pursuant to the provisions of Article 75 of the Commercial Corporations Act, controlling entities presumably include but are not limited to:

a) The entity who can appoint or remove most persons who are members of the governing body of a commercial corporation or persons in an equivalent position or members of the supervisory body of a commercial corporation, in which the entity is a member, or may enforce such appointment or removal; and

b) The entity who disposes of a share in the voting rights constituting a minimum of 40% of all voting rights in the commercial corporation, unless another entity or entities acting in concert dispose of the same or greater share; and

c) Entities acting in concert, who collectively dispose of a share in the voting rights constituting a minimum of 40 % of all votes in the commercial corporation, unless another entity or entities acting in concert dispose of the same or greater share.

Under the Czech law, the above presumptions of control are rebuttable presumptions. To the knowledge of the Commission services there is nevertheless no information supporting the opposite in the present case. Under these circumstances, there are therefore no doubts that AB private trust I is in the position of the controlling entity towards the company AGROFERT, a.s. as the controlled entity, or both Trust Funds (AB private trust I and AB private trust II) may be considered as the controlling entities of the company AGROFERT, a.s., as entities acting in concert and collectively holding a share in the voting rights constituting 100% of all votes in the company AGROFERT, a.s.

As for the question, whether a trust may be a controlled entity, the Czech authorities in their reply argue that under Article 74(1) of the Commercial Corporations Act, only a commercial corporation may be a controlled entity. However, the Act does not regulate controlled persons generally in relation to any controlled entities but only in relation to commercial enterprises and cooperatives (commercial corporations). The Czech legal order does not contain any general legal regulation on controlling. It must be inferred from interpretation and especially by reference to other laws and regulations that explicitly presume the possibility of controlling other entities than commercial corporations.

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21 E.g. Act No 277/2009 Coll. Insurance Act; definition in Article 3(3) and (6)

Act No 319/2006 Sb., on Certain Provisions regarding Transparency of Financial Relations regarding State subsidies; definition in Article 2(b) and (c)

Act No 134/2016 Coll. on Public Procurement; definition in Article 11(2) and (3)

Act No. 586/1992 Coll. on Income Tax; definition in Article 38fá(2) and (3)
Legal regulation, which explicitly presupposes the possibility of controlling trusts, is the Czech Anti Money Laundering (hereinafter ‘AML Act’). The idea that trust funds can be controlled is reflected also in the AML Directive and other documents published by international organisations on beneficial ownership[^22].

The person controlling a trust would then be, on the basis of the above legal theory and the way control is understood in Article 74 of Commercial Corporations Act, the person who is able to exercise the decisive influence within the two trusts.

On the basis of the above, the Commission services therefore maintain their position that under Czech law a trust fund can be not only controlling but also a controlled person.

It can be also argued that in fact only physical persons can claim that they are not controlled. It follows from their very nature that any legal person or entity, with or without a legal personality, is necessarily controlled as such persons or entities can only act thanks to physical persons. In the present case, since no legal presumption of control is being relied on for determining the person controlling the two trusts, the question whether this person is Mr Babiš is not so much a question of law but rather a question of fact. The Commission services in the draft audit report (section 5.1 point 2 ‘Identified facts’) and under the point 1.2 below demonstrate on the basis of the governance mechanisms of the Trust Funds that – in fact – Mr Babiš may exercise decisive influence in the Trust Funds and therefore controls them.

Last but not least even if it could be considered (quod non), e.g. by the national courts, that a trust fund cannot be regarded as a ‘controlled person’ for the purpose of Article 4c of Conflict of Interests Act, AGROFERT, a.s. as a commercial enterprise, can be considered to be a ‘controlled person’. Thus, the Trust Funds, even if not ‘controlled persons’ under that provision, could be regarded as ‘controlling persons’ of AGROFERT, a.s., or as a mechanism through which Mr Babiš controls AGROFERT, a.s.^[^23] Therefore, irrespective of the detailed argumentation regarding the entities in the chain of control, the conclusion will remain the same, i.e. the daughter/subsidiary companies of AGROFERT, a.s. are subject to the prohibition in Article 4c of Conflict of Interests Act.

The detailed reasoning of how Mr Babiš controls the trust funds he has founded is provided in the point 1.2 below.

### 1.2. Decisive influence over trust funds

[Points 26 – 37 of the Member State’s reply]

The Czech authorities argue that it is not possible to exercise a sufficiently strong influence through a trust fund because of the very nature of that instrument so that a trust fund cannot be considered a controlled person in the sense of Article 4c.

Regarding the above argument, it is not necessarily true that the person controlling the trust is the trustee (point 35 of Czech reply). Again, the matter turns on the actual powers retained by Mr Babiš over the trusts.


[^23]: See to the same effect also the conclusion in the opinion of the Czech Ministry of Justice of 30th November 2018 (ref. MSP-111/2018-OSZ-SP/1), p. 8
The Commission services are of the opinion that Mr Babiš is able to exercise not only a sufficiently strong influence within the Trust Funds but in fact a decisive influence (AB private trust I and AB private trust II), which can therefore be considered as entities controlled by him.

The activity of the Trust Funds and the position of Mr Babiš in the Trust Funds are defined in the Articles of Association of both Trust Funds. The following facts arise from the Articles of Association of AB private trust I dated 1 February 2017 and the Articles of Association of AB private trust II dated 1 February 2017 (with both texts being identical in essential articles) (hereinafter collectively referred to as the ‘Statutes’):

1. Mr Babiš was the sole shareholder of the AGROFERT, a.s. prior to founding the Trust Funds and, in the position of the founder of the Trust Funds, he has been the only entity who has had the ability since the beginning to set up the internal structure of both Trust Funds in a way that allows him to continue to exercise decisive influence over both Trust Funds;

2. Both Trust Funds were founded for private purposes with the primary purpose being the administration of shares of the AGROFERT, a.s., with further purpose essentially being the indirect control, through the AGROFERT, a.s., over the entire AGROFERT group

3. Another purpose of both Trust Funds is the protection of the interests of its founder Mr Babiš who is currently in the position of the beneficiary (Article 2 of the Statutes). That means that Mr Babiš himself decided on further decision-making and internal administration of both Trust Funds (or, where appropriate, their administration) in a way where such decision-making and internal administration must be always conducted to his benefit (in his interest).

4. The Trusts were created in order to transfer the shares to an entity that would be exercising the rights attached to the shares in the AGROFERT, a.s. in the interest of Mr Babiš. The purpose behind the Trust Funds was therefore not to transfer the title to the shares onto another entity fully independent of Mr Babiš. While Mr Babiš may not be the owner of the shares by law, the rights attached to the shares may be exercised only for the specified purposes, i.e. to administer the shares in the AGROFERT a.s., to protect the interests of the founder and beneficiary and

5. The Trust Funds have one trustee each, who is supposed to act independently (Mr Babiš was, is and will continue to be continuously and permanently associated with both the AGROFERT, a.s. and the entire AGROFERT group directly before (as regards the AGROFERT, a.s.) the establishment of the Trust Funds and after their dissolution, and indirectly through the Trust Funds during their existence.

6. The first trustee of both Trust Funds was appointed by the founder Mr Babiš.

In both the AB private trust I and AB private trust II Statutes, Mr Babiš vested in the trustee (a distinct person for each Trust Fund) the power to exercise rights
attached to the shares in the AGROFERT, a.s. placed in the Trust Fund. Those trustees are at the same time also in charge of business management in several AGROFERT group companies (in the case of the trustee of the AB private trust I) or currently in charge of business management of the AGROFERT, a.s. (in the case of the trustee of the AB private trust II).

Those personnel interconnections also lead to reasonable concerns about the trustee’s ability to act independently in the exercise of his authority to act.

7. Mr Babiš, as the founder, nominated one alternate trustee for each of the Trust Funds who will become the second trustee if the office of the first trustee ends. This means that, when establishing both Trust Funds, Mr Babiš exercised his decisive influence over the selection of the person to serve as the trustee in both Trust Funds also in the case where the initially appointed trustees are unable to continue to hold their offices for any reason.

8. Otherwise, trustees are removed and appointed by the Board of Protectors ( ) of each of the Trust Funds. Each Board of Protectors has three members with one of them always being a ‘family protector’ who can be appointed and removed by the beneficiary Mr Babiš. That way – by removing the family protector and potentially appointing another one – Mr Babiš is able to exercise his decisive influence over the selection of any subsequent trustee.

As regards the person appointed as the family protector, it must be noted that the Board of Protectors, as the supervising body, is responsible for the exercise of supervision to the founder and beneficiary, i.e. Mr Babiš. The supervising body is authorised to directly or indirectly direct the trustee, whom it supervises, adopt
measures to ensure due administration and enforce compliance with the trustee’s obligations.  

9. The initial members of the Board of Protectors were appointed by the founder ( ). The protectors are removed and appointed by the Board of Protectors, with the exception of the family protector who is removed and appointed by the beneficiary, i.e. Mr Babiš ( ).

10. This way – by removing the family protector – Mr Babiš is authorised to exercise his direct influence over the selection of any protector whose appointment to the Board of Protectors ends for any reason ( ).

11. The trustees of both Trust Funds are removed by the Board of Protectors ( ). The fact that any activity of the trustee in his position must protect the interests of the founder (Mr Babiš), while such interests are subjective and may change over time, indicates that Mr Babiš

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12. The trustees of the Trust Funds are required under Article 159(1) of the Czech Civil Code to act with due diligence to a reasonable extent. That means that the trustee must, utilising the necessary knowledge and diligently, administer the trust property, at the trustee’s own discretion but always in the interest of the beneficiary. The trustee must always act with the necessary loyalty to the founder and beneficiary. Despite the fact that trustees should act independently and at their own discretion, they must essentially (to meet the requirements for acting with due diligence in their position) act so as to achieve the purpose of the Trust Fund of which they are undoubtedly aware. This purpose is the administration of the shares in the AGROFERT, a.s. and, through these shares, of the entire AGROFERT group (as well as of the SynBiol, a.s. and the SynBiol group) and the protection of the interests of Mr Babiš. By defining the purpose of both Trust Funds, Mr Babiš limited and influenced in advance all future actions of the trustee in the administration of the property of the Trust Funds in a decisive manner.

13. Given that the main purpose of both Trust Funds is to administer the shares of the AGROFERT, a.s., there is a reasonable doubt, considering the nature and extent of the decisions, which are subject to the prior consent of the Board of Protectors, about the actual ability of both trustees to act independently in the administration of the property in the Trust Funds as theoretically declared in [BLANK].

In addition, Mr Babiš as the beneficiary is in reality able to block the activity of the Board of Protectors as well as the adoption of the decisions of the trustee listed above using the steps described in point 10 above. In this context, the rules seem to be obsolete as the beneficiary himself is entitled to block or directly prevent actions of the Board of Protectors and, consequently, the trustee.

In fact, this independent management of the
trustee can only be applied to a very limited extent, only in the common routine management of Trust Funds, and not in any important decisions.

14. This suggests that no changes to the AGROFERT, a.s. during the existence of the Trust Funds are permitted. Mr Babiš retained his powers to decide on changes to the AGROFERT, a.s., such changes may be made only after they are returned to him after the administration of the Trust Funds ends.

15. The timing and the circumstances, under which both Trust Funds were established, the duration of both Trust Funds as well as the conditions of the termination thereof clearly lead to the conclusion that both Trust Funds were established on purpose in order for the founder and sole shareholder of the AGROFERT, a.s. Mr Babiš to prevent the application of Articles 4b and 4c of the Conflict of Interests Act to a company in the AGROFERT group (for details refer to part 1.4 of this Conclusion).

16. From the described facts concerning both Trust Funds and their internal structure, as set by the Statutes, it can be concluded that Mr Babiš is:

a) the person who decides about the personnel of the Trust Funds: he appointed the initial trustees and their alternates ( ), appointed the initial members of the Board of Protectors ( ), appoints and removes the family protector ( )

b) 

c)
d) the person who determined the primary purpose of the Trust Funds, which is the administration of the property and protection of the interests of Mr Babiš;

e) the person, who explicitly determines in advance which transactions involving the property of the Trust Funds are permitted as all transactions involving the property in the Trust Funds are in line with the purpose of the Trust Fund;

f) the person who, given his actual ability, is able to exercise the voting rights attached to the shares of the AGROFERT, a.s. transferred to the Trust Funds;

g) the person who determined the duration of both Trust Funds in a way that ensures that the interests of Mr Babiš are protected;

h) the person who has the right to be informed.

Taking into consideration the facts arising from the Statutes of both Trust Funds and the fact that the trust funds are the controlling entities of the company AGROFERT as described under the point 1.1, the Commission services conclude that the requirements for indirect de facto control of Mr Babiš over the Trust Funds as well as the requirements for the direct, de facto and de jure, control of the Trust Funds over the AGROFERT, a.s. and other AGROFERT group companies have been met. Consequently, Mr Babiš controls AGROFERT group companies through the trust funds and Article 4c applies to those companies.

I.3. Mr Babiš’s real possibility to control trust funds

Points 38 – 47 of the Member State’s reply]

The Czech authorities argue (quod non) that even if trust funds could generally be considered as controlled persons under Article 4c of the Czech Conflict of Interests Act, it would have to be assessed if Mr Babiš is really controlling these funds. According to the Czech authorities, this is excluded due to the key provisions of the statutes of the two trust funds.

The Commission services have addressed this issue under the previous section, in reply to points 26 to 37 of the Member State’s reply.

Regarding point 47 of the Czech Republic’s reply, the Commission services would like to add that the notion of ‘control’ only requires the existence of a ‘possibility’ to exercise the decisive influence. It is not required that such decisive influence is actually exercised.\(^{25}\)

Moreover, the Commission services would like to add that the argumentation of the Czech authorities in points 46-47 of their reply is considered misleading. In point 46, the Czech Republic refers to the judgement in the Case T-292/15 Vakakis v Synergates\(^{26}\). However, that judgement was delivered in a very different context. The case dealt with the existence of a conflict of interest in the context of a procurement procedure managed by the Commission.

\(^{25}\) See also the opinion of the Czech Ministry of Justice cited above, p. 3

\(^{26}\) Judgement of 28 February 2018, ECLI:EU:T:2018:103; the case concerned an alleged conflict of interest of two experts participating in the drafting of the Terms of Reference.
and governed solely by the EU law. That case law is not applicable for determining whether a provision of the national law dealing with award of subsidies, such as Article 4c of Conflict of Interests Act, was breached.

Article 4c simply prohibits the award of grants to a certain category of beneficiaries. The applicability of that provision does not depend on whether it is actually found, under the national or EU law, that the concerned beneficiary is in situation of a conflict of interest or not, or whether there are sufficient risks that the conflict would have an impact on the award procedure or not, etc. The applicability of that provision only depends on the conditions laid down therein: i.e. whether the concerned person is a public officer and whether he/she owns or controls the shares of the company in the proportion required by the law.

Seen from that perspective, although Article 4c was certainly motivated by the problems linked to conflicts of interests, the provision alone is actually only dealing with eligibility of applicants. It is true that the provision appears very strict. It is however not up to the Commission to assess the appropriateness by the Czech Legislative authority to adopt such a law. The rationale behind such a strict approach might have been that in the Czech environment it was considered that only such a strict prohibition would provide adequate protection of the public funding.

1.4 Alternative reasoning to sections 1.1 - 1.3 above leading to the conclusion that Article 4c applies to the companies in AGROFERT group

The conclusion that Article 4c applies to companies in the AGROFERT group can be achieved also by alternative reasoning below, which is essentially based on the argument that founding the Trust Funds (AB private trust I and AB private trust II) can be considered as null. As a consequence Mr Babiš would still be considered as holding shares in AGROFERT, a.s. and Article 4c would apply to the companies in AGROFERT group.

It appears possible, according to the Czech legal theory, that the founder of a trust fund can appoint himself or herself the beneficiary. However, if the founder took on the roles of the founder, beneficiary and trustee, it would be apparent that the trust is expedient and therefore contrary to the purpose of a trust.

Regarding the content of the Statutes of both Trust Funds, it seems that these Trust Funds are at least approaching this situation, since Mr Babiš acts as the founder and the beneficiary, and at the same time, through the setting up of the internal functioning of both Trust Funds, he exerts a decisive influence on the person of the trustee through protectors (see section 1 above).

In this light it appears that the Trust Funds were founded contrary to Article 580 of the Czech Civil Code. The detailed reasoning is provided below.

The founder of the Trust Funds (AB private trust I and AB private trust II) is the sole beneficiary. All benefits from the Trust Funds belong to the founder who transferred the shares of the AGROFERT, a.s. into two Trust Funds.

The Trust Funds were founded immediately after the insertion of Article 4c in the Conflict of Interests Act. Under Article 4c of the Conflict of Interests Act, it is prohibited to provide a subsidy under a law or regulation governing budgetary rules or an investment incentive under a law or regulation governing investment incentives to a commercial enterprise in which a public officer as defined in Article 2(1)(c) of the Conflict of Interests Act or an entity controlled by him or her owns a 25% or greater ownership share in the commercial enterprise.

The principle of a trust is the allocation and transfer of property for a specific purpose, the establishment of separate and independent ownership, the benefits of which belong to the beneficiary. These legal actions are made by the founder.28

As described in point I.2 above, both Trust Funds were founded for private purposes with the primary purpose being the administration of shares in the AGROFERT, a.s. and the SyaBiol, a.s., and with further purposes being essentially indirect control, through the AGROFERT, a.s., over the entire AGROFERT group. Another purpose of both Trust Funds is the protection of the interests of its founder Mr Babiš who is currently in the position of the beneficiary ( ). That means that Mr Babiš himself decided on further decision-making and internal administration of both Trust Funds (or, where appropriate, their administration) in a way where such decision-making and internal administration must be always conducted to his benefit (in his interest).

The Trust Funds were created to transfer the shares of the AGROFERT, a.s. to an entity that would be exercising the rights attached to the shares in the AGROFERT, a.s. in the interest of Mr Babiš. The purpose behind the Trust Funds was therefore not to transfer the title to the shares onto another entity fully independent of Mr Babiš, an entity where there would not be any reason to have any doubts regarding the ability of Mr Babiš to influence such entity. While Mr Babiš may not be the owner of the shares by law, the rights attached to the shares may be exercised only for the specified purposes, i.e. to administer the shares in the AGROFERT, a.s., to protect the interests of the founder and beneficiary...

Given that Mr Babiš is a public officer, he is also subject to other provisions of the Conflict of Interests Act (not only Article 4c of the Conflict of Interests Act). Article 1(a) of the Conflict of Interests Act regulates 'the duty of public officers to perform their duties so as to prevent any conflict between their personal interests and the interests they are required to promote or defend in the performance of their duties'. It follows from Article 3 of the Conflict of Interests Act that 'a public officer must refrain from any act where his or her personal interests may affect the performance of his or her duties. As used in this Act, personal interest means any interest that yields for a public officer, a close person to a public officer, a legal entity controlled by a public officer or a close person to a public officer an increase in property, property or other benefits, prevents decreases in property or other benefits or other

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privileges; this does not apply if such a benefit or an interest evidently exists in relation to an unlimited group of beneficiaries’. That means that the purpose of these provisions is to protect public interests against the personal interests of the individual public officers. The Commission services are of the opinion that Mr Babiš, as a public officer, founded the Trust Funds in order to prevent the application of Article 4c of the Conflict of Interests Act. The reason for transferring the shares to the Trust Funds was not the protection of public interests but instead (as implied by the purpose of both Trust Funds) the protection of the interests of Mr Babiš as the founder and the entire AGROFERT group, i.e. protection of personal interests.

Such act, which meets formal statutory requirements but actually operates against the sense and purpose of the law could be, in our opinion, assessed as null under Article 580(1) of the Czech Civil Code.

Article 580(1) of the Czech Civil Code stipulates that: ‘A legal act is also null if it is contrary to good morals or contrary to the law, if so required by the sense and purpose of the law.’ Consequences of violating Article 580(1) of the Czech Civil Code are also regulated in Article 588 of the Czech Civil Code which stipulates that ‘a court shall, even of its own motion, take into account the nullity of a legal act which is manifestly against good morals or which is contrary to the law and manifestly disrupting public order.’ Article 588 of the Czech Civil Code regulates nullity that is taken into account by the court ex officio, i.e. absolute nullity.

The Commission services base their interpretation of the term ‘public order’ contained in Article 588 of the Czech Civil Code on the explanatory memorandum on the Czech Civil Code and the individual previously published opinions aimed at understanding public order as a term that represents rules and values contained in the legal order with such significance that violations of such rules and values are unacceptable and therefore any legal acts contrary thereto must be absolutely null. The explanatory memorandum explains that ‘public order permeates the entire law and includes the rules, on which the legal foundations of the social order of the local society stand.’ Similarly, F. Melzer believes that ‘public order consists of the basic rules of the legal order, compliance with which must be insisted on unconditionally, i.e. such rules, compliance with which cannot be left solely to the initiative of the individuals concerned’ (Melzer, 2013, p. 256). P. Bezouška and L. Piechowiczová also stated that public order gives ‘the legal order its own value and governing principles without which a democratic society cannot function. In other words – it is a term describing a set of basic legal institutes that form the foundation for the constitutional building of a legal state and society’ (Bezouška, Piechowiczová, 2013, p. 12)²⁹.

In our opinion, the ‘law’ can, in the present case, be represented by the Conflict of Interests Act (including but not limited to Article 4c of the Conflict of Interests Act, Article 3 of the Conflict of Interests Act) and public order can be seen as the overriding public interest in strict compliance with the prohibition of conflict of interests. A public officer is elected by citizens to promote the interests of the society, and not to promote his own personal interests, mainly, in his efforts to evade the application of Article 4c of the Conflict of Interests Act, by founding Trust Funds and transferring shares of the AGROFERT, a.s. in such Trust Funds and by subsequently applying for subsidies, i.e. funds from the State budget, EU funds, State financial assets or the National Fund, himself or via the AGROFERT group.

As regards good morals, there have been numerous attempts in the theory and practice of civil law to define the term. The Supreme Court has been defining goods morals as ‘the sum of social, cultural and moral norms that have proven a certain consistency over time, reflect significant historical tendencies, are shared by a substantial part of society and have the nature of basic norms’ (R 5/2001). According to the Constitutional Court, ‘good morals are the sum of ethical, generally accepted and recognized principles, the compliance with which is often secured through legal norms so as to ensure that each act is in compliance with the general moral principles of a democratic society. This general horizon, whose moral content also develops in space and time through the development of the society, must also be assessed on a case-by-case basis taking into account the specific time, place and mutual actions of the parties to the legal relationship.’ (II. 38 249/97). According to V. Knapp, good morals ‘do not form a social normative system, but they are a measure of ethical evaluation of specific situations in accordance with generally recognized rules of decency, honest conduct, etc.’ (Knapp, 1995, p. 85).

As implied by the above commented definitions of good morals, it is in the interest of the society as a whole to respect the prohibition of conflicts of interest of public officials. Public officials lead by example dully and honestly complying not only with the prohibition of conflict of interests but the entire legal system.

Given the above, it would be possible to reach the conclusion that the Trust Funds were founded to protect the personal interests of Mr Babiš and the entire AGROFERT group with a view to evade the application of Article 4c of the Conflict of Interests Act to the activities of the AGROFERT group. If Mr Babiš actually controlled the AGROFERT, a.s. and the AGROFERT group, i.e. recipients of subsidies (funds from the State budget), such conduct, i.e. the purpose of the conduct and the purpose of the Trust Funds would possibly not only go against good morals but it could be contrary to the sense and purpose of Article 4c of the Conflict of Interests Act and interfere with public order. For this reason, it can be concluded that the Trust Funds could be null since their founding may have satisfied the formal requirements but their purpose could be seen as a purpose that is contrary to the sense and purpose of the Conflict of Interests Act.

II. Application of the Article 4c of the Czech Conflict of Interests Act

II.1. Mr Babiš as a public officer

[Points 48 – 49 of the Member State’s reply]

The Czech authorities argue that the prohibition set in Article 4c of the Czech Conflict of Interests Act concerns only public officers as defined in Article 2(1)(c) of the latter act and point out that Mr Babiš in the period from 25 May 2017 to 6 December 2017 has not fall under the definition of public officer set in Article 2(1)(c).

The Commission services acknowledge that Mr Babiš was not a public officer as defined in Article 2(1)(c) of the Conflict of Interests Act[31] in the period from 25 May 2017 to 5 December 2017. On 6 December 2017 Mr Babiš was appointed Prime Minister of the Czech Republic.

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31 Under Article 2(1)(c) of the Conflict of Interests Act, for the purposes of the Act, ‘public officer’ means a member of the government or the head of another central administrative authority not headed by a member of the government
The Commission services also agree that it must be assessed as of the date of issue of the award decision (rozhodnuti o poskytnuti dotace) whether the conditions specified in Article 4c of the Conflict of Interests Act prohibiting the provision of a subsidy under the set conditions have been met.

Therefore, the Commission services consider that all AGROFERT group projects for which the award decision was issued in the period from 25 May 2017 to 5 December 2017 are not subject of Article 4c of the Czech Conflict of Interests Act.

II.2. Transitional provision of the Czech Conflict of Interests Act

[Points 50 – 56 of the Member State’s reply]

The Czech authorities argue that for the application of Article 4c of the Czech Conflict of Interests Act the transitional provision in Article II(1) of Act No 14/2017 should be taken into account and that for the date when the procedure on the provision of grant commenced, this should be considered as being the date of the Call for projects.

Firstly, the Conflict of Interests Act was amended by Act No 14/2017. Act No 14/2017 inserted into the Conflict of Interests Act the following Article 4c:

'It is prohibited to provide a subsidy under a law or regulation governing budgetary rules\textsuperscript{32} or an investment incentive under a law or regulation governing investment incentives\textsuperscript{33} to a commercial enterprise in which a public officer as defined in Article 2(1)(c) or an entity controlled by him or her owns a 25\% or greater ownership share in the commercial enterprise.'

Under Article VIII of Act 14/2017, this (amending) act came into force on 1 September 2017 except for Article I(17), Article II(6) and Article IV which came into force on the 15\textsuperscript{th} day after the promulgation of the act, i.e. 9 February 2017. That means that the above-cited Article 4c of the Conflict of Interests Act came into force on 9 February 2017, since it was contained in Article I(17).

The transitional provision in Article II(1) of Act No 14/2017 stipulated that:

'The prohibition in Article 4c applies to an award procedure or an investment incentive started after the entry into force of this Act. Procedures started prior to the date of entry into force of this Act will be completed in accordance with the previous laws and regulations'.

The above-cited transitional provision came into force, under Article VIII of Act No 14/2017, only on 1 September 2017. This is due to the fact that the provision (Article II(1)) is not listed in exceptions that would be coming into force on the fifteenth day after the promulgation (i.e. on 9 February 2017).

Nevertheless, the Commission services are of the opinion that, in the light of the relevant case-law of the Supreme Administrative Court\textsuperscript{34}, it must be concluded that the non-inclusion of the transitional provisions themselves among the exceptions of earlier entry into force is 'the lack of consistency of the legislator', who could not intend that in the relevant period, a

\textsuperscript{32} Act No 218/2000 on Budgetary Rules and Amending Certain Related Acts (Budgetary Rules), as amended

\textsuperscript{33} Act No 72/2000 on Investment Incentives and Amending Certain Related Acts (Investment Incentives Act), as amended

\textsuperscript{34} Judgement of the Supreme Administrative Court 7 As 87/2018, point 28
transitional provision, which is merely incidental does not apply. This inconsistency of the legislator has to be overcome by a teleological interpretation (in line with the cited decision of the Supreme Administrative Court), so that the transitional provision Article II.1 of Act No 14/2017 had to take effect on the same day as the amendment of the legal provision to which it relates (Article 4c of the Act on Conflicts of Interest), i.e. on 9 February 2017. Thus, taking into account the Supreme Administrative Court decision, the prohibition laid down in Article 4c had to apply to all grant procedures initiated after 9 February 2017.

Consequently, if the commercial companies referred to in Article 4c submitted a grant application before 9 February 2017 Article 4c would not apply to these proceedings as, in accordance with the case law of the Supreme Administrative Court, the transitional provision of Article II.1, provided that procedures started before the date of coming into force of the Act, would be supposed to be completed in accordance with the previous laws and regulations. (i.e. in accordance with the Conflict of Interests Act without the application of Article 4c).

Secondly, as regards the date when the procedure on the provision of grant commenced, the actual subsidy procedure is regulated in part two of the Budgetary Rules Act No 218/2000 (hereinafter 'Budgetary Rules Act'). The issue of the submission of grant applications and their formalities are regulated in Article 14(3) of the Budgetary Rules Act. The grant procedure is additionally regulated by the general rules applicable to administrative proceedings contained in the Code of Administrative Procedure (with the exceptions defined in Article 14q of the Budgetary Rules Act). Under Article 44(1) of the Code of Administrative Procedure, any administrative 'subsidy procedure starts on the day when the application or another motion starting the proceedings is delivered to the administrative authority with jurisdiction and venue'. Article 14(3) of the Budgetary Rules Act as valid before 31 December 2017 expressly stipulated that 'the provider decides on the provision of a subsidy or repayable financial aid based on the recipient's application'.

According to Article 14(3) of the Budgetary Rules Act in conjunction with Article 44(1) of the Code of Administrative Procedure or according to Article 14(3) of the Budgetary Rules Act in force until 31 December 2017, a subsidy procedure always starts only based on a submitted grant application on the day when such application is duly delivered in accordance with the conditions defined in the call.

Article 14j(1) of the Budgetary Rules Act stipulated that a:

‘Call for grant applications or repayable financial aid is published in a manner which allows remote access. The content of the call must be accessible for a minimum of 30 days prior to the deadline for the submission of applications. The call contains information about its subject-matter, defines the group of eligible subsidy applicants, the deadline for the submission of applications and any other requirements that must be met by the applicant for the subsidy and information about supporting materials.’

The applicant can submit the grant application only based on a call previously published by the grant provider. The moment of publication of a call, for example, on the grant provider’s website cannot be considered as the start of subsidy procedure because such an interpretation would be in conflict with the above-cited provision in Article 44(1) of the Code of Administrative Procedure (as well as Article 14(3) of the Budgetary Rules Act as in force before 31 December 2017). For the same reason - due to a conflict with Article 44(1) of the Code of Administrative Procedure - no other moment in time can be considered the start of subsidy procedure. Therefore, the Commission services consider that grant procedure starts only with the submission of the grant application.
As regards a subsidy procedure started after 9 February 2017, all authorities deciding on subsidies were required, with no exceptions, to apply Article 4c of the Conflict of Interests Act. For this reason, it was necessary to assess whether the application was subject to the prohibition in Article 4c of the Conflict of Interests Act or not. It was not possible to provide subsidies to applicants subject to the above prohibition, i.e. it was not possible to issue an award decision or conclude a subsidy agreement.

If the grant award decision was issued after 9 February 2017 and:

- subsidy procedure started in the period before 9 February 2017, previous laws and regulations would apply until the issuance of the decision and during the actual decision-making, i.e. the prohibition in Article 4c of the Conflict of Interests Act would not apply;
- subsidy procedure started in the period after 9 February 2017, all authorities deciding on subsidies were required, with no exceptions, to apply Article 4c of the Conflict of Interests Act. For this reason, it was necessary to assess whether the application was subject to the prohibition in Article 4c of the Conflict of Interests Act or not. It was not possible to provide subsidies to applicants subject to the above prohibition, i.e. it was not possible to issue an award decision or conclude a subsidy agreement.

II.3. Projects subject to Article 4c of the Conflict of Interests Act

[Points 57 – 59 and 112 of the Member State’s reply]

The Czech authorities argue that several projects reported by the Commission auditors should not fall under Article 4c of the Conflict of Interests Act due to the fact that a) Mr Babiš was not public offer as specified in Article 2(1)(c) of the latter act and b) transitional provision set in Act No 14/2017 was applicable. Moreover, the Czech authorities claim that the table in the Annex II.b of the draft audit report does not reflect whether the affected expenditure was declared to the Commission or withdrawn from the accounts.

The Commission services agree that based on the conclusion specified under the above-mentioned point II.1, the following projects from the Annex II.b of the draft audit report are not subject to Article 4c of the Conflict of Interests Act due to the fact that Mr Babiš was not public offer when the grant award decisions have been taken:

<table>
<thead>
<tr>
<th>Project number</th>
<th>Project name</th>
<th>Date of grant award decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>CZ.01.3.10/0.0/0.0/0.0/16_061/0008384</td>
<td>Rationalisation of heat consumption for heating of buildings</td>
<td>3.7.2017</td>
</tr>
<tr>
<td>CZ.05.2.32/0.0/0.0/0.0/15_008/0001081</td>
<td>Greening of energy source, Wotan Forest, a.s. - Solnice</td>
<td>31.7.2017</td>
</tr>
<tr>
<td>CZ.05.3.24/0.0/0.0/0.0/16_044/0004552</td>
<td>Long-term environmental burden, NAVOS, Boršov (Kyjov)</td>
<td>30.8.2017</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0.0/16_061/0010507</td>
<td>Energy savings at the PRIMAGRA plant in Klatovy</td>
<td>13.9.2017</td>
</tr>
<tr>
<td>CZ. 01.3.10/0.0/0.0/0.0/16_061/0010455</td>
<td>Kostelecké uzeniny - Most - comprehensive energy measures</td>
<td>11.11.2017</td>
</tr>
</tbody>
</table>

The Commission services consider that, based on the conclusions specified under the above-mentioned point I.2., the award of the grants to these operations for which the grant award decision was concluded after 5 December 2017 (i.e. after Mr Babiš became again a public
official) and for which the grant applications were submitted after 9 February 2017 was irregular due to the breach of Article 4c of the Conflict of Interests Act (see the table below).

<table>
<thead>
<tr>
<th>Project number</th>
<th>Project name</th>
<th>Date of grant award decision</th>
<th>Grant application submitted</th>
</tr>
</thead>
<tbody>
<tr>
<td>CZ.01.1.02/0.0/0.0/0/17_109/0011122</td>
<td>Technology innovations for the preparation of sulphur fertilizers</td>
<td>19.7.2018</td>
<td>28.7.2017</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0/16_061/0011011</td>
<td>Technologies to reduce energy performance in production, Ethanol Energy a.s.</td>
<td>13.4.2018</td>
<td>26.6.2017</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0/16_061/0011139</td>
<td>Replacement of grain dryer for more energy-efficient technologies, Havlíčkův Brod</td>
<td>26.1.2018</td>
<td>31.7.2017</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0/16_061/0011143</td>
<td>Replacement of grain dryer for more energy-efficient technologies, Chotěboř</td>
<td>26.1.2018</td>
<td>31.7.2017</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0/16_061/0011152</td>
<td>Replacement of grain dryer for more energy-efficient technologies, CEREA Ríkov</td>
<td>15.3.2018</td>
<td>2.8.2017</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0/16_061/0011875</td>
<td>Replacement of grain dryer for more energy-efficient technologies, Dobrénice-Syrůváka</td>
<td>24.5.2018</td>
<td>26.10.2017</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/0/16_061/0011988</td>
<td>Replacement of grain dryer for more energy-efficient technologies, Jičín</td>
<td>23.5.2018</td>
<td>31.10.2017</td>
</tr>
</tbody>
</table>

Consequently, the Commission services consider that for the 7 projects mentioned in point 2 above the decision on award of grant was invalid due to the breach of Article 4c of the Conflict of Interests Act.

As regards point 112 of the reply from Czech authorities, the Commission services took note that all related expenditure affected by the breach of Article 4c listed in Annex II.b of the draft audit report was withdrawn from the 2017-2018 accounts under Article 137(2) of the CPR for ongoing assessment, except for a project of the company Wotan Forest, a.s. However, following the analysis of the Czech reply to the draft report, the auditors removed this project from the list of ineligible projects.

II.4. General consideration on the financial corrections due to the conflict of interests

[Point 111 of the Member State’s reply]

The Czech authorities argue that application of 100% financial correction for the projects awarded in breach of Article 4c of the Conflict of Interests Act is not justified and proportionate and request that the actual impact of the breach should be taken into account for the quantification of any financial correction.

Article 85(1) states that ‘the Commission shall make financial corrections by cancelling all or part of the Union contribution to a programme and effecting recovery from the Member State, in order to exclude from Union financing expenditure which is in breach of applicable law.’ Article 85(4) specifies that ‘criteria and procedures for applying financial corrections shall be laid down in the Fund-specific rules’.

As regards funding awarded from the ERDF, the ESF, the Cohesion Fund and the EMFF, the criteria and procedures for applying financial corrections are laid down in Articles 144 and 145 of the CPR.
Article 144(1) of the CPR provides that

‘the Commission shall make financial corrections by cancelling all or part of the Union contribution to an operational programme’ where, after carrying out the necessary examination, it concludes inter alia that ‘expenditure contained in a payment application is irregular and has not been corrected by the Member State prior to the opening of the correction procedure under this paragraph’.

In accordance with Article 144(2), the Commission is to respect the principle of proportionality when deciding on a financial correction, ‘by taking account of the nature and gravity of the irregularity’.

If a breach of Union and/or national applicable law can be established and this breach entails that the EU funding in question should never have been awarded, the financial correction would need to amount to 100%. This is the case concerning the breaches of Article 4c of the Conflict of Interests Act in relation to the ESI funds concerned. As it was prohibited to provide subsidies to entities covered by Article 4c of the Conflict of Interests Act, the impact has to be proportionately assessed at 100% (i.e. the entire amount of the prohibited subsidy is ineligible). There is no discretion for the Commission services to apply financial correction lower than 100% in such cases.

III. Other aspects of the Commissions auditors’ observations

III.1. Possibility to dismiss a civil servant by the government

[Points 60 – 65 of the Member State’s reply]
The Czech authorities argue that the government cannot directly dismiss senior civil servants as it decides only on the systematisation of the service authority (systematizaci služebních úřadů). The Czech authorities argue that the systematisation for 2018 was fully in line with the Act on the Civil Service (Zákon o státní službě).

The Commission services take note of the Czech authorities’ assertion that the government cannot directly dismiss senior civil servants and do not contest the legality of the systemisation approved by the government at the end of 2017. The aim of the example used was to illustrate decisions taken by the government under the Prime Minister’s authority in the management of ESI funds.

III.2 Mr Babiš as a member of the ESIF Council and his influence over horizontal bodies

[Points 13, 66 – 69 and 75 – 77 of the Member State’s reply]
The Czech authorities argue that Mr Babiš relinquished the post of Chair of the ESIF Council, took no further part in its meetings or in any government decisions concerning ESI funds. They also argue that it is not true that the ESIF Council’s conclusions form the basis for subsequent decision by ministers responsible for the implementation of EU funds.

Furthermore, the Czech authorities argue that the tasks of horizontal bodies consist in the formal discussion, and possibly adoption, of certain documents, which nevertheless are drawn up by other bodies over which Mr Babiš does not and cannot exert any influence. Moreover, the Czech authorities argue that the Commission does not make it clear exactly where and how influence was exerted.

During the period audited, Mr Babiš occupied the post of Chair of the ESIF Council, in fact until the end of 2018.
Based on the Statute of the ESIF Council, the chairman of the ESIF Council *inter alia*:

a) chairs the deliberations of the Council and manage the work of the Council;

b) submits to the members of the Council proposals of materials for discussion;

c) approves the agenda of the Council's meetings; and

d) determines the responsibilities for the tasks arising from the Councils resolutions.

Therefore, the auditors maintain their statement from the draft audit report that the impartial and objective exercise of Mr Babiš' functions during the period where he was Chair of the ESIF Council was compromised, due to the fact that he was involved in decisions which also affected the AGROFERT group.

Whilst the Commission services welcome the measures already taken to address the situation of conflict of interests as indicated in the Member State reply above, it is important that Mr Babiš continues to recuse himself from participating in any decision related to ESI funds, including transparently documenting this, and abstaining from communicating with or influencing decision makers, either in person or through representatives, on EU funding related to his or his family's economic interests in the company AGROFERT, a.s. and the AGROFERT group.

The Commission services also take note that Mr Babiš has no longer participated in the relevant discussion points of the Council for ESI funds and would welcome further clarification on when the related measures will become effective, notably the entry into force of the change to Czech law with respect to the participation of Mr Babiš in the Council for ESI funds.

Although the Commission services acknowledge that Mr Babiš does no longer preside and does not participate in the deliberations or decision-making in relation to the AGROFERT group, his position as Prime Minister provides him with a possibility to exercise influence outside formal deliberations and decision-making process.

In the present case, measures which would limit the responsibilities of Mr Babiš while remaining Prime Minister would not seem sufficient to address the issue.

As regards the comments presented by the Czech authorities under the points 68 and 69, the Commission services agree that conclusions from the ESIF Council are to be approved by the government. However, the Commission services reiterate their position that the conclusions of the ESIF Council are the basis for further decision making by the government and ministers responsible for the implementation of EU funds (in the function of the managing authority). For example, conclusions of the ESIF Council on the re-allocations of the funds, measures to be taken and national priorities are typical areas involving implementation further down the cascade by the relevant ministers.

Finally, this section is not conclusive as to whether the situation of a conflict of interest under Article 61 of the Financial Regulation 2018 has been adequately addressed and does not prejudice in any way the result of any future procedures performed by the Commission to ensure proper implementation of EU funds.

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35 Government decree from 27 April 2016 No 362
III.3 Article 4(1) of the Czech Conflict of Interests Act

[Points 70 – 73 of the Member State’s reply]

The Czech authorities argue that Mr Babiš was not carrying out a business activity in breach of Article 4(1) of the Conflict of Interests Act and that the Commission’s interpretation is inconsistent with the definition of business activity contained in Article 420 of the Czech Civil Code. Moreover, the Czech authorities refer to the Supreme Administrative Court’s judgement to which the Commission itself refers.

The Commission services agree that having a shareholding in itself is not the exercise of activities contrary to Article 4(1)(a) of the Conflict of Interests Act and, consequently, does not fall within the definition of conflict of interests because, under Article 4(2) of the Conflict of Interests Act, the restrictions in paragraph (1) do not apply to the administration of one’s own property. That means that a having shareholding in itself is not the exercise of business or other gainful activities.

The Czech Supreme Administrative Court has endorsed that approach, citing previous case-law in which it was indeed stated that mere ownership of shares can be considered as the administration of one’s own assets. However, the Supreme Administrative Court went on to observe that a shareholding must be viewed as the exercise of business activity or the exercise of managing activity under certain circumstances. In paragraphs 35 and 36 of the same judgement it stated that:

(35) It certainly does not follow from the previous case-law that any participation of a bailiff in the public limited liability company (ownership of shares in a public limited liability company) is compatible with law, as the defendant pretends. On the one side, it is necessary to state that the mere circumstance that a person is a shareholder of a public limited company is certainly not per se against Article 3(2) of the Enforcement Code. By the way, in the today’s society the ownership of shares, special investment funds and other securities is absolutely a normal phenomenon. It is certainly not a business activity. However, considering the limitation on gainful activities in professions such as bailiffs and judges, it always depends on a concrete situation. Generally, the bigger the share-holding in the commercial enterprise (which also brings along the status of the controlling person or the majority shareholder – Articles 73 and 74 of the Commercial Corporations Act No 90/2012) the bigger the danger that Article 3(2) of the Enforcement Code […] will be breached. Of course, it cannot be excluded that even 96% or 100% participation in a public limited liability company is not infringing Article 3(2) of the Enforcement Code. Typically, it would be when the commercial enterprise is not really carrying out an economic activity but when it is founded for the purpose of managing the property of the bailiff, i.e. for the administration of one’s assets.

(36) If, however, such commercial enterprise is carrying out an economic activity […], with the view to the circumstances and the character of the economic activity Article 3(2) of the Enforcement Code could be breached […]. Even greater difficulty arises when the bailiff is a majority shareholder with personal links to the statutory organ of the company (in the present case the husband of the defendant), in particular considering the clear meaning of Article

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37 Judgement in the case 14 Kse 1/2017, point 34

38 Judgment in the case 15 Kse 4/2013
3(2) of the Enforcement Code, which is to ensure independence and impartiality of the bailiff. [...] (cf. ruling of the Supreme Court of 21 May 2008, file no 29 Cdo 152/2007).

It follows from the above that the Czech Supreme Administrative Court clearly considers that holding controlling shares may fall under the notion of gainful activity and therefore not fall under the exception of the administration of one’s own assets. It certainly does not follow from that judgment that any shareholding in a public limited liability company falls under the exception of the administration of one’s assets. On the contrary, the higher the shareholding the higher the risk that it will not be considered as a mere administration of one’s assets.

Although the Supreme Administrative Court reached this conclusion when assessing conflict of interests in the case of a bailiff, the Commission services are of the opinion that there is no reason for the Supreme Administrative Court to reach a different conclusion when assessing conflict of interests in the case of a public officer. The judgment concerned disciplinary proceedings against a bailiff who owned a majority share in a real estate agency and dealt with a prohibition contained in Article 3(2) of the Czech Enforcement Code (Act No 120/2001), which is similar to the prohibition in Article 4(1) of the Conflict of Interests Act and which reads:

'(2) The activity of a bailiff is incompatible with another gainful activity, with the exception of the administration of one’s own assets. However, the bailiff may, also in exchange of a remuneration, carry out scientific, publication, pedagogical, interpretation, expert and artistic activities and activities in the advisory bodies of the government, ministries, other central organs of the State and within local government.

The interpretation provided in the Member State’s reply of the above-cited Supreme Administrative Court’s judgement is considered misleading and it cannot be considered that this judgment supports the argument of the Czech authorities expressed in point 71 of their reply.

Mr Babiš as the sole shareholder exercised the powers of the general assembly of the company AGROFERT, a.s. which is the supreme body of a joint-stock company. According to the statutes dated 23 January 2015 and 24 June 2016, the powers of the general meeting also included deciding on appointments and removals of members of the Board, the Supervisory Board and the Audit Committee, changes to the statutes, increasing or decreasing the registered capital, approving the company’s business strategy, medium-term business plans and annual business plans.

The sole shareholder decides on the running of the entire company, is in charge of the entire company and manages the company. Therefore, the Commission services consider that Mr Babiš was, at the time when he was the sole shareholder of the company AGROFERT, a.s., in the position of a person controlling the company AGROFERT, a.s. (and also the AGROFERT group) because he was able to, in that period, exercise decisive influence over this company (the entire AGROFERT group) directly as well as indirectly, depending on the

'article 74(1) of the Commercial Corporations Act defines a controlling entity as ‘an entity that is able to exercise decisive influence over a commercial corporation directly or indirectly. A controlled entity is a commercial corporation controlled by a controlling entity.’

Article 75 of the Commercial Corporations Act stipulates that:

(1) A controlling entity shall be deemed to be the entity who can appoint or remove the majority of persons who are members of the governing body of a commercial corporation or persons in an equivalent position or members of the supervisory body of a commercial corporation, in which the entity is a member, or may enforce such appointment or removal.
circumstances. Based on the presumptions of control described in Article 75 of the Commercial Corporations Act, Mr Babiš was the controlling person of the company AGROFERT, a.s.

The Commission services consider that prior to the founding of the Trust Funds, Mr Babiš could exercise activity contrary to Article 4(1)(a) of the Conflict of Interests Act because he, as the person controlling the company AGROFERT, a.s., had the ability to exercise direct and indirect influence over the company’s operations and business. Therefore, Mr Babiš was not a mere shareholder without managing competence.

As regards the period after the founding of the trust funds, it has been concluded in section I above that Mr Babiš still controls the company AGROFERT, a.s. and the AGROFERT group. The above statement concerning the period before the founding of the Trusts Funds would then also apply to the period thereafter with the difference that Mr Babiš would not be the person making decisions regarding the business activities of the company AGROFERT, a.s. and its managing person due to his position of the sole shareholder of the company AGROFERT, a.s. but due to his position of a person actually indirectly controlling the company. We could consequently conclude that Mr Babiš was exercising activity contrary to Article 4(1)(a) of the Conflict of Interests Act also after the founding of the trust funds.

The Czech authorities also seek to rely on the definition in Article 420 of the Czech Civil Code. This definition however does not concern ‘business activity’ as the Czech authorities claim but rather the definition of ‘entrepreneur’ and reads as follows:

‘A person who, on his own account and responsibility, independently carries out a gainful activity in the form of a trade or in a similar manner with the intention to do so consistently for profit is considered, with regard to this activity, to be an entrepreneur.’

It is therefore not clear how that definition supports the Czech position. Moreover, Article 4(1) of the Conflict of Interests Act does not only refer to business activity but also to any other ‘gainful’ activity. Last but not least, it is to be noted that the above judgment by the Czech Supreme Administrative Court in the case 14 Kse 1/2017 was issued notwithstanding the existence of the mentioned definition in Article 420 of the Czech Civil Code.

Finally, the Commission services consider that the mere fact that the performance of activities is required by law certainly does not mean that those activities fall outside the scope of a business activity. The Commission services recall that Mr Babiš made decisions (see the list of examples in section 5.1, point 2(4) ‘Identified facts’ of the draft audit report) as to how the profits are distributed and who is appointed, maintained or dismissed in the statutory organs. Therefore, no matter if those decisions are required by law, as a result of 100% ownership of shares, Mr Babiš made those decisions in full discretion, in the way he wished. Such decision-making powers, when exercised, intervene in the management of the company. The exercise of such power therefore amounts to engaging in a business or gainful activity in the sense of Article 4(1) of the Czech Conflict of Interests Act.

(2) A controlling entity shall be deemed to be the entity who controls a share in the voting rights constituting a minimum of 40% of all votes in the commercial corporation, unless another entity or entities acting in concert dispose of the same or greater share.

III.4 Examples of decision from which AGROFERT group benefited

[Points 78 – 101 of the Member State’s reply]

The Czech authorities argue that the main decision-making body for the integrated risk management system is the Risk Management Committee and that the Commission assertion that the funds were transferred with the aim of benefitting the chemical industry and hence also AGROFERT group is erroneous. Furthermore, the Czech authorities explain the reasons behind the re-allocation of the funds between the operational programmes.

Firstly, the Czech authorities agree that the ESIF Council and government approved the corrective measures to be taken by the MAs. The Commission services do not question the role of the Risk Management Committee in the integrated risk management system. However, the role of the ESIF Council and government is also very important. This is supported by the description of the integrated risk management system that the government is involved in the third phase of the integrated risk management process, (i.e. work with the results of the risk analysis). It is only based on the approval of the corrective measures by the government, that these measures become binding for all subjects of the implementing structure.

Secondly, the Commission services acknowledge the background information provided by the Czech authorities as regards the transfer of funds from the OP Transport to the OP Environment. The Commission services take into account the information that until 31 May 2016 only three project applications were registered under the OP Transport and that there was a real risk of non-fulfilment of n+3 rules for the latter OP.

Finally, the Commission services take into account the information that so far only one project of the AGROFERT group (beneficiary Wotan Forests, a.s.) has been selected from priority axis 2 (specific objective 2.2).

III.5 Mr Babiš as a person involved in the implementation of EU budget

[Points 102 – 106 of the Member State’s reply]

The Czech authorities argue that the definition of all persons provided by the Commission is totally imprecise and the Prime Minister cannot be considered as a financial actor or person involved in budget implementation. Moreover, the Czech authorities argue that according to Recital 104 of Financial Regulation 2018, Article 61 should be interpreted sticto sensu.

The function and powers of the Prime Minister, which are outlined in more detail below, provide him with an opportunity to steer and influence decision-making processes linked with implementation of funds coming from the EU budget. Even if the Prime Minister participates in high level decision-making, mainly involving priority setting, his functions and powers provide him with possibility of also exercising influence on lower levels of the government.

Even if the government itself decides as a collegial organ (Article 76 of the Czech constitution), the Prime Minister, as head of the government, has among other the following powers and functions:

- he provide the main policy orientations to the government (according to Article 77 of the Czech constitution, he among other organises the government’s activities, presides over its meetings and acts in its name);

- he proposes other members of the government to the President for appointment (Article 68(2) of the Czech constitution) and can require the President to recall them (Article 74 of the Czech constitution).

- he co-signs legislative acts (Article 51 of the Czech constitution) and certain other regulatory acts.

In the Czech Republic, the government proposes the State budget and is responsible for its implementation. Within limits laid down by law, the government therefore proposes the priorities of public spending and the allocation of funding to those priorities. The amounts of public spending that are later reimbursed by ESI funds form part of the revenue in the State budget. For ESI funds, within the framework laid down by the EU law, the Czech government lays down, in consultation with the relevant managing authorities, the priorities for spending by adopting the Partnership agreement and subsequently the individual Operational Programmes, which are then approved by the Commission.

Furthermore, specifically in relation to ESI funds, the Czech government approves:

- major revisions of the programmes proposed by the Ministry for Regional Development in cooperation with the managing authority (e.g. reallocation of part of the funds from one programme to another programme or reallocation of funds between priority axes of one programme in case of slow implementation);

- measures to improve implementation of ESI funds proposed by the Ministry for Regional Development in cooperation with the managing authorities (after the consultation of the Council for ESI funds);

- measures proposed by the ESIF Council.

Furthermore, Mr. Babis, as a Prime Minister, also presided over the ESIF Council up to December 2018, which is a permanent overarching professional and advisory body to the Government of the Czech Republic with regard to the coordination of EU aid from all the ESI funds. It provides advice on orientation of the interventions of all ESI funds in the Czech Republic in the 2014-2020 programming period.

In addition, the decisions of the government bind all members of the government, ministries, other central administrative organs and other administrative organs.

Furthermore, the reply from the Czech authorities provides a narrow interpretation of Article 61. The Commission services maintain, that it follows from the wording of Article 61(1) and (3) of the Financial Regulation 2018 that this provision aims to cover, as widely as possible, all potential situations of a conflict of interest of any person intervening in budget implementation since Article 61(1) refers to:

- financial actors and other persons, including national authorities at any level;
- all management modes: direct, indirect and shared management;
- budget implementation but also acts preparatory thereto;
- not taking any action, which may result in a conflict of interests;
- taking appropriate measures also to prevent a conflict of interest from arising and address it if it arises, including any situations objectively perceived as a conflict of interest.

Article 61(3) then defines the conflict of interest very widely as a situation 'where the impartial and objective exercise of the functions of a financial actor or other person, as
referred to in paragraph 1, is compromised for reasons involving family, emotional life, political or national affinity, economic interest or any other direct or indirect personal interest’.

Regarding the argument by the Czech Republic concerning Recital 104 of the Financial Regulation 2018, the Commission services underline that the extract cited by the Czech authorities is quoted out of its context. In order to understand the meaning of the Recital it needs to be read in its entirety:

‘(104) It is appropriate that different cases usually referred to as situations of conflict of interests be identified and treated distinctly. The notion of a ‘conflict of interests’ should be solely used for cases where a person or entity with responsibilities for budget implementation, audit or control, or an official or an agent of a Union institution or national authorities at any level, is in such a situation. Attempts to unduly influence an award procedure or obtain confidential information should be treated as grave professional misconduct which can lead to the rejection from the award procedure and/or exclusion from Union funds. In addition, economic operators might be in a situation where they should not be selected to implement a contract because of a professional conflicting interest. For instance, a company should not evaluate a project in which it has participated or an auditor should not be in a position to audit accounts it has previously certified.’.

It is apparent from the first sentence of Recital 104 and then from the rest of the recital, that it in fact aims to distinguish between three cases that might in the past have all been treated within the notion of a conflict of interest, but which should under the Financial Regulation 2018 be distinguished:

1. conflict of interest – which is defined in Article 61 and which is to be ‘solely’ used for cases where a person or entity with responsibilities for budget implementation, audit or control, or an official or an agent of a Union institution or national authorities at any level, is in such a situation;

2. grave professional misconduct – which applies to a situation where someone attempts to unduly influence an award procedure or obtain confidential information; and

3. professional conflicting interests – which arises, for example in a situation where a company would be called upon to evaluate a project in which it has participated or an auditor would be called upon to audit accounts he/she has previously certified.

It is therefore clear from the reading of the entire recital that the word ‘solely’ in relation to the notion of a conflict of interests needs to be read in opposition to the two other notions, i.e. grave professional misconduct and professional conflicting interests. In other words, the word ‘solely’ only indicates that the notion of conflict of interest should not be confused with the situations of grave professional misconduct or professional conflicting interests. Therefore, that word does not limit the scope of Article 61 itself, which, as explained above, is worded in a way to ensure its widest possible application.

As the government of the Czech Republic participates in the management of the ESI funds, the Prime Minister, as the member and head of the government, as any other minister, falls within the notion of ‘other person, including national authorities at any level involved in budget implementation under f. . . f shared management, including acts preparatory thereto’ within the meaning of Article 61(1) of the Financial Regulation 2018.
Conclusions

The conclusions of the Commission services have been revised in the light of the analysis of the reply of the Czech authorities. The Commission services consider that:

a) Mr Babiš controls the companies in the AGROFERT group (refer to parts I.1-I.4 of the Commission's conclusion).

b) Projects awarded to the AGROFERT group after 9 February 2017 are in breach of Article 4c of the Conflict of Interests Act provided that: (i) the project application has been submitted after 9 February 2017 and (ii) the project was awarded when Mr Babiš was a public officer (refer to parts I.1, II.1, II.2 and II.3 of the Commission's conclusion);

c) Mr Babiš was actively involved in the implementation of the EU budget in the Czech Republic (refer to parts III.1, III.2, III.4 and III.5 of the Commission's conclusion);

d) Mr Babiš as a public officer was in breach of Article 4(1) of the Conflict of Interests Act (refer to parts III.3 of the Commission's conclusion);

e) During the audited period, the impartial and objective exercise of Mr Babiš functions (as Prime Minister, the Chairman of the ESIF Council, Minister for Finance and Deputy Prime Minister for Economy) was compromised, due to the fact that he was involved in decisions which also affected the AGROFERT group (refer to parts III.2 of the Commission's conclusion).

As per Article 59(1) and (4) read in conjunction with Article 32(3) of the Financial Regulation 2012 and Article 63(1) and (4) read in conjunction with Article 36(3) of the Financial Regulation 2018 the Czech management and control systems should avoid conflict of interest. As per Article 74 of CPR, the Member State shall “fulfil the management, control and audit obligations, and assume the resulting responsibilities, which are laid down in the rules on shared management as set out in the Financial Regulation and the Fund-specific rules”. Czech Conflict of Interests Act, and in particular Articles 4(1) and 4c, are one of the requirements how to prevent a conflict of interests in the public sector. Therefore, on this basis, the Commission services’ conclusions are the following:

i) For the operations subject to the audit, the Czech management and control systems did not ensure effective control including the avoidance of conflict of interest due to continuous breach of Article 4(1) of the Czech Act No 159/2006 on conflict of interests prior to the founding of the Trust Funds, because Mr Babiš, as the person controlling the company AGROFERT, a.s., had the ability to exercise direct and indirect influence over the company's operations and business and therefore, he was not a mere shareholder without managing competence;

However, the Commission services understand that Czech national law on conflict of interest did not prohibit granting of public funds, including EU funds, to companies in which the public official was involved.

Therefore, due to the inherent difficulty in assessing the prejudice to the EU budget, no financial corrections are proposed by the Commission in respect of this breach of national rules or Article 32 (3) of Regulation 966/2012.
ii) after the founding of the Trust Funds, it has been concluded in section I above that
Mr Babiš still controls the AGROFERT company and the AGROFERT group,
due to his position of a person actually indirectly controlling the company and is
therefore still in breach of Article 4(1) of the Czech Act No 159/2006 on conflict
of interests.

iii) For the operations subject to the audit, in addition to the Czech management and
control systems continued non-compliance with Article 59(1) and (4) read in
conjunction with Article 32(3) of the Financial Regulation of 2012 and Article
63(1) and (4) read in conjunction with Article 36(3) of the Financial Regulation
2018 due to continuous breach of Article 4(1) of the Conflict of Interests Act,
there has been a continuous breach of Article 4c of the Conflict of Interests Act
since 9 February 2017. 7 ERDF grants awarded to AGROFERT group companies
after that date did not comply with Article 4c of the Conflict of Interests Act. The
Commission auditors did not identify any evidence of undue influence over the
audit authority during the period when Mr Babiš was Minister for Finance.

In addition and separately from the issue of conflict of interests, the audit identified individual
ersors demonstrating the existence of serious deficiencies in the functioning of the
management and control systems for both periods 2007-2013 and 2014-2020 (See sections 5.2
and 5.3).

**Action to be taken/recommendation**

Due to the continuing breaches of articles 4(1) and 4c of the Czech conflict of interest law, the
national authorities are requested to:

(a) Make the necessary improvements to the management and control systems to
ensure compliance with Article 59(1) and (4) read in conjunction with Article
32(3)c of the 2012 Financial Regulation and Article 63(1) and (4) read in
conjunction with Article 36(3) of the Financial Regulation 2018;

(b) verify all grants awarded for which a grant application was submitted on or
after 9 February 2017 for both of the 2014-2020 operational programmes
audited (i.e. the Enterprise and Innovation for Competitiveness OP and the
Environment OP) to ensure that they were awarded in compliance with Article
4c of the Conflict of Interests Act, as concerns possible conflict of interests
situations that may have affected grants awarded to any beneficiary. Financial
corrections and cancellation of the related public contribution should be
implemented for any irregular operations identified by this verification. The
Commission services draw the attention of the national authorities to the need
to consistently apply the applicable law in respect of the other 2014-2020
operational programmes and beneficiary companies in light of the identified
breaches of Article 4(1) and 4c for the AGROFERT group or in any similar
situations identified.

(c) advise of any actions taken or proposed to be taken for the non-compliance of
Mr Babiš with these provisions.
(d) For the Enterprise and Innovations OP 2014-2020 and the Environment OP 2014-2020, improve the systems to ensure the effective functioning of the management verifications to identify and correct breaches of the relevant conflict of interests rules and

(e) For the 2014-2020 programming period, the managing authority for the Enterprise and Innovations OP 2014-2020 is requested to cancel the public contribution to the 8 irregular operations identified by the audit (see Annex II for details of these corrections / cancellations of the public contribution).

Importance: Critical
Body responsible: MAs/CA
Deadline for implementation: 2 months
5.2. ERDF and CF Findings and actions to be taken / recommendations

During the period from 13 June 2011 until 3 July 2018, companies from the AGROFERT group were granted 98 ERDF / CF operations under four operational programmes (ENV OP 2007-2013 and 2014-2020; Enterprise and Innovation 2007-2013 and 2014-2020).

The table and chart below show the evolution between 2011 and 2018 of the number of operations (grants signed) with companies from the AGROFERT group and the EU contribution for ERDF and CF for these same companies:

<table>
<thead>
<tr>
<th>Year</th>
<th>Environment Operational programmes</th>
<th></th>
<th></th>
<th></th>
<th>Enterprise and Innovation Operational programmes</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of operations</td>
<td>EU Contribution</td>
<td></td>
<td></td>
<td>Number of operations</td>
<td>EU contribution</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>CZK</td>
<td>EUR</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
<td>1</td>
<td>13,770,000</td>
<td>533,721</td>
</tr>
<tr>
<td>2012</td>
<td>5</td>
<td>7,825,842</td>
<td>303,327</td>
<td></td>
<td>8</td>
<td>226,548,203</td>
<td>8,780,938</td>
</tr>
<tr>
<td>2013</td>
<td>19</td>
<td>373,415,551</td>
<td>14,473,471</td>
<td></td>
<td>8</td>
<td>122,143,000</td>
<td>4,734,224</td>
</tr>
<tr>
<td>2014</td>
<td>25</td>
<td>410,940,717</td>
<td>15,927,935</td>
<td></td>
<td>5</td>
<td>52,201,413</td>
<td>2,023,311</td>
</tr>
<tr>
<td>2015</td>
<td>3</td>
<td>7,657,758</td>
<td>296,812</td>
<td></td>
<td>1</td>
<td>4,005,000</td>
<td>255,233</td>
</tr>
<tr>
<td>2016</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
<td>3</td>
<td>17,033,175</td>
<td>660,201</td>
</tr>
<tr>
<td>2017</td>
<td>2</td>
<td>86,865,838</td>
<td>3,366,893</td>
<td></td>
<td>11</td>
<td>186,162,970</td>
<td>7,215,619</td>
</tr>
<tr>
<td>2018</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
<td>7</td>
<td>134,680,907</td>
<td>5,220,190</td>
</tr>
<tr>
<td></td>
<td>54</td>
<td>886,705,707</td>
<td>34,368,438</td>
<td></td>
<td>44</td>
<td>756,544,668</td>
<td>29,323,437</td>
</tr>
</tbody>
</table>

AGROFERT Group: yearly evolution between 2012 and 2018 of the number of ERDF/CF operations (grants signed, left axis) and EU contribution in EUR (right axis)

The figures above indicate that for ERDF/CF:

(i) There was a peak in the value of the AGROFERT group operations grants signed in November 2013 (i.e. before Mr Babiš became Minister of Finance) and in March
2014 (i.e. after Mr Babiš became Minister of Finance). For the grants signed in March 2014, it is reasonable to consider that they have been awarded based on proposals submitted earlier than 29 January 2014.

(ii) There was a peak in the number of AGROFERT group operations grants signed in June 2014, i.e. when Mr Babiš was Minister of Finance and
5.2.2. Environment OP (2007CZ161PO006) and Environment OP (2014CZ16M10P002)

5.2.2.1. System findings

Finding 02

Key requirement: KR 2 - Appropriate selection of operations

**Code of Ethics not implemented in practice in the case of the Steering Committee for the OP Environment in the programming period 2007-2013**

The Implementing Document for the Environment OP 2007-2013, approved on 10 November 2008 (further referred to as ‘the Implementing Document’), lays down the rules to be followed by all stakeholders involved in the implementation of the OP. In particular, Chapter 12 ‘Code of Ethics’, is the *fundamental ethical standard for the presentation of OP Environment (...) and internal and external staff involved in the implementation of this programme*[^42].

The Code sets out and describes the principles of conduct of persons involved in the implementation of the Environment OP (hereinafter ‘ENV OP’). It lays down the following requirements with regard to the management and disclosure of conflict of interests:

20. A Member[^43] shall refrain from any action that would create a conflict of public interest with his or her private interest.

21. A Member shall not use information related to its activities within the framework of the implementation and functioning of the ENV OP for personal benefit or the benefit of other persons.

22. Where a Member has a private interest in a project to be involved in the implementation of the ENV OP, he/she shall notify the collective body of which he/she is a member or its superior before discussing the matter.

23. In the event of a conflict of interest, where a Member is a project promoter or processor or has been involved in the processing, or has a close family, emotional, economic or political relationship with the promoter or processor, the Member shall not participate in the discussion and assessment of the project.'

In accordance with Chapter 12 of the Implementing Document, the Code applies to the following stakeholders:

- Employees of the Ministry of Environment in its capacity of Managing Authority for the ENV OP;
- Other internal staff employed under technical assistance of the ENV OP;
- Employees of the Intermediate Body - the State Environmental Fund of the Czech Republic;
- External collaborators dealing with the ENV OP;
- Members of the Steering Committee of the ENV OP;

[^42]: Implementing Document of the OP Environment, Chapter 12.

[^43]: As defined in Chapter 12 of the Implementing Document, the term ‘Member’ refers to any ‘member of the ENV OP Implementation Structure’, i.e. any person involved in the implementation of the ENV OP.
• Members of the Monitoring Committee of the ENV OP.

The Steering Committee recommends the selection of the projects and actions supported by the ERDF and the CF on the basis of the project selection criteria approved by the Monitoring Committee and is an ‘advisory body to the managing authority, submitting to it proposals and recommendations’. The Committee initially consisted of 29 members and was subsequently increased to 31 members. The Ministry of the Environment (as managing authority) and the State Environmental Fund (as intermediate body) have representatives in the Steering Committee. Other members are representatives of other Ministries, members of selected Parliamentary and Senate committees, representatives of the Union of Towns and Municipalities of the Czech Republic and of non-governmental organisations.

Based on a review of the documentation related to the setup and the work of the Steering Committee, the auditors identified the following:

i) the rules included in the Code of Ethics have not been reflected in the statute of the Steering Committee;

(ii) there is no evidence that the members of the Steering Committee have been made aware of these rules;

(iii) the auditors have not been provided with evidence confirming that these rules were transposed in the Rules of procedure of the Committee.

The managing authority informed the Commission services that the members of the Steering Committee systematically signed declarations of impartiality and confidentiality and provided the auditors with a template of the declaration. The auditors requested copies of the declarations signed by each member of the Steering Committee on their nomination or when participating in the meetings. In reply to this request, six copies of declarations were provided out from at least 53 declarations due. The auditee explained that it was not able to find a file containing all the requested documents.

For the programming period 2014-2020, the Steering Committee was replaced by a Selection Committee, with similar functions as those for the 2007-2013 period. However, the members of the Selection Committee are obliged by the statutes of the Committee to follow the Code of Ethics, in annex to the statutes, which explains clearly that conflict of interests should be avoided.

Action to be taken / recommendation

Recommendation 02.01

The national authorities are requested to provide the missing declarations of impartiality and confidentiality signed by the members of the Steering Committee mentioned above.

Importance: Very important

Body responsible: Managing authority/Intermediate body acting as the secretariat to the Selection Committee for the 2014-2020 programming period.

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44 During the audit the Commission auditors checked five meetings of the Steering Committee (out of 45 meetings in total, which took place in the period from 2008 to 2015), which were relevant to the selection of the sampled projects. In total, 53 Steering Committee members were identified, who attended those five meetings.
Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[122] Finding No 2 refers to a deficiency in the form of the failure to provide all declarations of impartiality and confidentiality signed by members of the OP Environment Steering Committee. The required declarations of impartiality and confidentiality signed by the members of the OP Environment Steering Committee are attached as an annex to this document.

[123] We would also point out formal errors in the use of the terms ‘Steering Committee’ / ‘Selection Committee’ and regarding the programming period in question in the text of Finding No 2 (page 25 of the Czech version), where it is stated that:

‘For the programming period 2014-2020, the Steering Committee was replaced by a Selection Committee, with similar functions as those for the 2007-2013 period.’ However, the members of the Steering Committee are obliged by the statutes of the Committee to follow the Code of Ethics, (…)

[124] This should read:

‘For the programming period 2014-2020, the Steering Committee was replaced by a Selection Committee, with similar functions as those for the 2007-2013 period.’ However, the members of the Selection Committee are obliged by the statutes of the Committee to follow the Code of Ethics, (…)’

[125] Also:

‘Body responsible: Managing authority/Intermediate body acting as the secretariat to the Steering Committee for the 2014-2020 programming period.’

[126] This should read:

‘Body responsible: Managing authority/Intermediate body acting as the secretariat to the Steering Committee for the 2007-2013 programming period.’

As the missing documents have been provided, we request that this finding be removed in its entirety.

Conclusion of the Commission services:

The finding is closed.

The Commission services have reviewed all 53 copies of declarations of impartiality and confidentiality provided by the Czech authorities in response to recommendation 02.01 of the draft audit report.

Out of those 53 declarations provided, 17 declarations provided are relevant to the sampled meetings. Overall, together with the six declarations received during the on-the-spot visit, the Commission services received 23 declarations relevant for the sampled meetings.

Although no project related to the 2007-2013 programming period was identified as being affected by a conflict of interest issue, the auditors nonetheless draw the attention of the Programme authorities on the importance of ensuring compliance with their own rules related
to avoiding conflict of interest, i.e. to ensure that the relevant COI declarations are completed by all the members of the Steering Committee and that an audit trail of these records is maintained in accordance with the rules.

The Commission also notes the Member State explanation concerning the use of the term 'Steering Committee' and has ensured the correction of this term in the final audit report.

As the audit did not identify any projects in the 2007-2013 programming period affected by a conflict of interest issue, the recommendation is closed.
Finding 03

Key requirement: KR 2 - Appropriate selection of operations

Absence of minimum point’s threshold for the evaluation criteria approved by the Monitoring Committee for the OP Environment 2007-2013

According to Article 60 of Council Regulation (EC) No 1083/2006, ‘The managing authority shall be responsible for managing and implementing the operational programme in accordance with the principle of sound financial management and in particular for:

(a) ensuring that operations are selected for funding in accordance with the criteria applicable to the operational programme and that they comply with applicable Community and national rules for the whole of their implementation period’ (...)

Furthermore, under Article 65 of the Council Regulation (EC) No 1083/2006, ‘The monitoring committee shall satisfy itself as to the effectiveness and quality of the implementation of the operational programme, in accordance with the following provisions:

(a) it shall consider and approve the criteria for selecting the operations financed within six months of the approval’ (...)

Absence of minimal threshold - total

The evaluation criteria approved by the Monitoring Committee for measures 5.1 and 2.2 of the Environment OP 2007-2013 did not have any minimum threshold (i.e. a minimum number or percentage of points) that an application should score in order to be recommended for financing.

As a result, all applications for financing within measure 5.1, which fulfilled the eligibility criteria, were recommended and approved for financing.

This absence of a minimum threshold led to a situation where applications with as few as 30 points out of 100 were financed, as was the case in call 26 for some companies that were not part of the AGROFERT group. In the audit sample of AGROFERT group operations, operation CZ.1.02/2.2.00/11.12743 - AGRO Jevišovice was financed having scored 46.75 points out of 100 in the substantive assessment.

Absence of a minimum threshold per selection criteria

Minimum thresholds were not systematically set for individual criteria.

As regards measure 2.2, an application could only be excluded following the substantive evaluation based on the criterion of the cost-effectiveness of the operation. Operation CZ.1.02/2.2.00/11.12743 - AGRO Jevišovice had a value of 999.99 for the financial intensity for reducing emissions criterion. A value of 1000 or more in that criterion would have excluded the operation from financing.

Minimum thresholds for the total number of points and for individual criteria would help to ensure that operations selected for funding meet certain minimum standards and that they are selected in accordance with the principle of sound financial management. Not defining such thresholds may lead to the risk that EU financial resources are used to finance projects of a low quality standard.

Action to be taken / recommendation

The Czech authorities should ensure that, in all future calls under the 2014-2020 programming period and future one, thresholds are set, requesting a minimum number of
points per criteria and/or a minimum percentage of the total number of points. Only applications, which reach these minimum thresholds should be approved for funding.

Importance: Very important

Body responsible: Managing authority

Deadline for implementation: next call for the 2014-2020 programming period and future one

Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[127] On a general note, we would point out that OP Environment 2007-2013 had already been closed, but we would add with regard to the example of the AGRO Jevisovice project cited in this finding that the project evaluation process took place in a number of phases. This project as such had first to get through the general and specific acceptability phases, where the primary contribution to the fulfillment of indicators (monitoring indicators) for the environmental sector in question are assessed; in the case of the AGRO Jevisovice project, this was air quality and the reduction of pollutant emissions, specifically ammonia. This was followed by the scoring process (in the first phases of evaluation): points being awarded for the size of the emissions reduction, the siting of the project (areas with degraded air quality receive more points) and the specific financial intensity of the reduced emissions. On the basis of the points obtained, the positively evaluated projects were then 'merely' ranked. Priority was then given to supporting projects which obtained a higher score.

[128] It is not true that the aid provider did not set any minimum points threshold for determining whether a project would or would not be funded. The 'red zero' was clearly defined for the evaluation criteria concerned, specifically the criterion Specific financial intensity of emission reductions, i.e. where an applicant exceeded the financial limit set.

[129] We would add that General Regulation No 1083/2006 for the 2007-2013 period lays down only a basic framework of rules and principles for the selection and evaluation of projects which MAs must adhere to when selecting projects to be supported. However, it is individual MAs and/or MCs that determine the specific manner in which these principles are to be implemented, and hence the procedures and criteria for evaluating and selecting projects.

[130] With regard to the recommendations made in connection with this finding, we would inform you as follows. Under OP Environment 2014-2020, a minimum points threshold is always set for all competitive calls, and submitted applications must attain this threshold in order to qualify for support. The minimum points threshold is always specified in the text of the relevant competitive call. The wording of the call must also be in line with the binding Methodological Guidelines for the management of calls and project selection and evaluation (available at https://www.dotaceu.cz/cs/Fondy-EU/2014-2020/Methodick-pokyny/Metodika-rizeni-programu/Metodika-rizeni-vzvez-/hodnoceni-a-vyberu-projektu) that are drawn up by the National Coordination Authority.

[131] The evaluation criteria for OP Environment 2014-2020 were drawn up in accordance with established rules with the aim of selecting the best-quality projects. The

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criteria were therefore drawn up to ensure the efficiency, value for money, effectiveness, and feasibility of projects and that they are needed, with a view to meeting the substantive objectives of the programme and focusing individual specific aims or supported activities. The criteria are divided into several subsectors within which projects are awarded a specific number of points for compliance with the relevant criterion; the criteria are clearly defined and take account of the aforementioned quality aspects of projects. The evaluation therefore includes an assessment of the cost-effectiveness of the projects submitted - as a rule the amount of total eligible expenditure per unit of measurement (e.g. m³, t, kW, etc.), the percentage decrease/increase in a certain value, etc. Material such as the Construction Works Price Catalogue (costs must not exceed these prices) is also used, or the Ministry of the Environment’s costs of standard measures. In a number of cases, the ‘red zero’ principle is also used, which means that, if a project receives 0 points for a given sub-criterion, it does not pass the substantive evaluation and is eliminated, even though it might have received the full number of points for the other criteria. This principle is generally used when evaluating a project’s per specific financial costs in relation to compliance with indicators, for example. Substantive evaluation results in the award of a final score, which is the sum total of points awarded for the individual sub-criteria (except in cases of elimination on the basis of a ‘red zero’). It is then verified that the resultant score is equal to or exceeds the minimum points threshold set in the call. Applications which do not meet the evaluation criteria or do not attain the minimum score are eliminated from the subsequent phase of administration.

[132] Attainment of the minimum score or percentage compliance with individual sub-criteria is generally not used for OP Environment. Nor is this desirable since, for the PA2 sub-criterion ‘Evaluation on the basis of project siting’, a project receives points depending on the site’s immision load, and this may be regarded as very good even for a project that has received the minimum number of points for a given sub-criterion. The required quality of projects is ensured not only by obtaining the minimum score out of the total possible number of points (for the individual sub-criteria set with regard to the aforementioned quality aspects) but also by the set-up of the programme itself and of the individual calls (including related documentation).

[133] Evaluation criteria are discussed by thematic working groups for the priority axes concerned; these include representatives of partners, academia, etc. and, after having been duly discussed, the criteria are submitted to the 2014-2020 monitoring committee for approval. Monitoring committee meetings are also attended by Commission representatives who make active use of their right to express opinions on the points under discussion. The same approach is also used for any change to the criteria.

[134] As competitive calls are not suitable for all areas that receive aid, permanent (non-competitive) calls are also used in accordance with the Methodological Guidelines for the management of calls and project evaluation and selection for OP Environment; these do not include a substantive evaluation (scoring), only compliance with a certain set standard being taken into consideration on the basis of formal requirements and project acceptability criteria of an eliminatory nature. Aid is provided to beneficiaries whose projects meet these conditions, in the order in which their aid applications were submitted. For permanent calls, project evaluation is a continuous process, so it is not necessary to wait for the end of the call in order to carry out an evaluation, which may begin once the aid application has been submitted. These calls are also open for a longer period for the receipt of applications. Compared with competitive calls, individual applications are administered much more rapidly and the whole administrative burden is reduced. This means there is one barrier to absorption capacity less for applicants, namely the wait to find out whether a project will be supported or not in view of the amount of allocation. Permanent calls are therefore used in
particular for activities where there is a need to ensure continuous availability of funding and a limited number of eligible applicants, and for projects of a similar kind or where there is *de facto* no competition.

[135] Formal requirements and acceptability criteria are also laid down in advance before a call is published and are set out in the OP Environment Rules for Applicants and Beneficiaries.

[136] Formal requirement criteria are set out in Part C.2.1.1 of the Rules for Applicants and Beneficiaries, are identical for all priority axes and are subject to approval by the monitoring committee.

[137] Acceptability criteria vary from one priority axis or specific objective to another and are set out in the relevant part of Chapter B of the Rules for Applicants and Beneficiaries. These criteria, too, are discussed by the relevant thematic working groups and are subject to approval by the MC.

[138] For permanent calls, the cost-effectiveness requirement is generally included in the acceptability criteria, or in the list of eligible costs, and they are also set out in Part B of the Rules for Applicants and Beneficiaries subject to approval by the monitoring committee.

[139] In a number of specific cases, e.g. integrated territorial investments (ITI) and calls in priority axis 4, the acceptability criteria are complemented by evaluation criteria for which the applicant must also attain the minimum score specified in the call as part of the set of evaluation criteria discussed by the thematic working group and approved by the MC.

[140] With regard to PA2 ‘Improvement of air quality in human settlements’ and SO 3.5 ‘Reduction of environmental risks and development of systems for their management’ in OP Environment 2014-2020, we would point out that there is no longer any funding free in the OP for launching further calls for aid applications.

In the light of the above, we do not agree with finding or recommendation No 3 and request that they be removed.

**Conclusion of the Commission services:**

The finding is **closed**.

The auditors take note of the clarifications provided by the Czech authorities.

In particular, the auditors take note that the Czech authorities confirm in their reply that the so-called ‘red zero’ was defined for only one evaluation criterion, i.e. the criterion ‘Specific Financial Intensity of Emission Reductions’. This confirms the finding from the draft audit
report which stated that for the programming period 2007-2013, ‘minimum thresholds were not systemically set for individual criteria’.

Concerning the statement of the Czech authorities that ‘On a general note, we would point out that OP Environment 2007-2013 had already been closed’, the auditors did not challenge this fact and the recommendation in the draft audit report relates to future calls for the 2014-2020 programming period.

The auditors acknowledge the confirmation of the Czech authorities that under OP Environment 2014-2020:

(i) a minimum points threshold is always set for all competitive calls, and submitted applications must attain this threshold in order to qualify for support.

(ii) in a number of cases, if a project receives 0 points for a given sub-criterion, it does not pass the substantive evaluation and is eliminated and

(iii) applications which do not meet the evaluation criteria or do not attain the minimum score are eliminated from the subsequent phase of administration.

Therefore, the finding is closed.
Key requirement: KR 2 - Appropriate selection of operations

Ineligible projects due to conflict of interests – 2014-2020 programming period

According to Article 4c of Conflict of Interests Act, which entered into force on 9 February 2017:

'It is forbidden to provide a subsidy under the legislation governing budgetary rules or investment incentives under the legislation governing investment incentives to a commercial enterprise in which a public official as referred to in Article 2(1)(c) or the controlled entity of such a public official owns a share representing a holding of at least 25 % in the commercial enterprise'.

Since May 2016, the IB-SFZP legal department verifies the ownership structure with the support of the ARACHNE IT system, complemented by the use of the Cribis IT system since 1st January 2018: the legal department traces the ownership structure of beneficiaries down to the level of a physical person. However, it does not check whether the identified physical person (e.g. owner of the entity) is a ‘public official’ owning a 25 % or more of a commercial enterprise (Article 4c of the Conflict of Interests Act).

In this regard, the auditors noted that for project CZ.05.2.32/0.0/0.0/15_008/0001081, the financing agreement was signed with the company Wotan Forest on 31 July 2017, i.e. after the above-mentioned amended Conflict of Interests Act entered into application. Similarly, the financing agreement for project CZ.05.3.24/0.0/0.0/16_044/0004552 was signed on 30 August 2017.

Reference is made to the system finding 1 above, which concludes that for the period after 9 February 2017, in addition to Mr Babiš continued non-compliance with Article 4(1), grants awarded to AGROFERT group companies after that date did not comply with Article 4c of the Conflict of Interests Act. They are therefore irregular and a 100% financial correction should be applied to all related expenditure declared to the Commission for these operations.

In the case of the two above-mentioned projects, the Legal Department stopped its investigation at the level where it obtained the name of the final owner. However, it did not conclude on any conflict of interests.

Therefore, the auditors conclude that the potential conflicts of interest are not adequately verified according to Article 4c of the Conflict of Interests Act and the two above-mentioned projects are ineligible.

Action to be taken / recommendation

(a) The managing authority is requested to correct the expenditure already declared to the Commission in respect of this operation and to cancel the public contribution to it (see recommendation under finding 1).

(b) The managing authority is requested to ensure that the legal department verifies whether the identified physical person (e.g. owner of the entity) is a ‘public official’ owning a 25 % or more of a commercial enterprise (Article 4c of the Conflict of Interests Act).

Importance: Critical

Body responsible: Managing authority

Deadline for implementation: 1 month
Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[142] Finding No 4 of the EU audit concerns the following projects:

a) Reg. No: CZ.05.2.32/0.0/0.0/15_008/0001081
Project name: ‘Greening of the energy source Wotan Forest, a.s. – Solnice’
Applicant/beneficiary: Wotan Forest, a.s.
Application submitted on 15 December 2015, grant award decision issued on 31 July 2017

b) Reg. No: CZ.05.3.24/0.0/0.0/16_044/0004552
Project name: ‘Environmental liabilities – NAVOS company in Boršov (Kyjov)’
Applicant/beneficiary: NAVOS, a.s.
Application submitted on 29 December 2016, grant award decision issued on 30 August 2017

[143] Regarding application of Article 4c of the Conflict of Interests Act, please see the analysis of finding No 1, in particular points 16-59.

[144] In finding No 4, the audit states that since 2016 the legal department of the IB-SFZP, with the help of the ARACHNE and CRIBIS IT systems, has verified the ownership structure of grant applicants down to the level of a natural person, but does not deal with whether natural persons of this kind have a possible conflict of interests.

[145] Moreover, checks are always carried out to determine whether any grant applicants (thus the companies Wotan Forest and NAVOS) also meet the requirements laid down in both EU and national legislation.

[146] This check of compliance with legislative requirements includes in particular an examination of the ownership structures of legal entities, but subsequently also an appraisal of whether any applicant in the form of a commercial enterprise meets the requirements concerning a possible conflict of interests – for which the legal department of the IB-SFZP appropriately applies Article 4c of the Conflict of Interests Act, as amended – applicable to the period during which the application procedure is conducted and until the grant decision is to be issued. In other words, checks are always conducted to determine whether the applicant has a conflict of interests.

[147] Commercial enterprises in the Czech Republic are by their nature always holding companies. No commercial enterprise exists for which it would not be possible to quantify a share or shares.

[148] Article 4c of the Conflict of Interests Act of 9 February 2017 provides:

‘It is forbidden to provide a subsidy under the legislation governing budgetary rules or investment incentives under the legislation governing investment incentives to a commercial enterprise in which a public official as referred to in Article 2(1)(c) (or member of the government) or the entity controlled by such a public official owns a share representing a holding of at least 25 % in the commercial enterprise.’

[149] According to those provisions, a public official is a member of the government or the head of another central administrative authority not headed by a member of the government.

[150] In the specific case of the applicants (the commercial enterprises Wotan Forest and NAVOS), an investigation was conducted into whether or not the aforementioned requirement had been met, namely whether any member of the government or any entity controlled by
him/her owned a share of at least 25% in those companies.

[151] The aforementioned investigation was carried out by staff from the legal department of the IB-SFZP immediately before it was decided whether all the legislative requirements had been met and whether or not it was possible to issue a legal act for the provision of support under budgetary rules (grant award decision). In view of the above, the audit team’s assertion that the legal department of the State Environment Fund of the Czech Republic did not bother to establish whether there was a possible conflict of interests is not based on fact.

[152] In the case of project CZ.05.3.24/0.0/0.0/16_044/0004552 this investigation and verification took place on 14 August 2017, and in the case of project CZ.05.2.32/0.0/0.0/15_008/0001081 this investigation and verification took place on 17 July 2017. It is clear that verification of the ownership structure and conflict of interests took place immediately before the relevant grant award decision was issued (which the auditors were provided evidence of on site during the audit mission). This verification proved negative, as no natural person meeting the requirements of ownership under Article 4c of the Conflict of Interests Act was to be found either in the ARACHNE system – which, according to the European Commission, serves as a tool for disclosing ownership structures – or in the CIRIBIS system, which the intermediate body acquired at its own expense.

[153] In view of this, the legal department of the IB-SFZP came to the conclusion during its checks that the requirement for excluding the applicant under Article 4c of the Conflict of Interests Act had not been met because no member of the government (or entity controlled by a member of the government) owned a share of at least 25% in the commercial enterprises Wotan Forest or NAVOS.

[154] Checking of the ownership structure and consequent possible conflict of interests is always carried out by staff from the legal department of the IB-SFZP. It would have to be proved during those checks that at least 25% of the shares of Wotan Forest a.s. were owned either directly by a specific member of the government or by an entity controlled by him/her (a legal entity, and an entity given legal personality – Article 15 of the Civil Code).

[155] The checks concerning the companies Wotan Forest and NAVOS showed that more than 25% of them are owned by the company AGROFERT a.s. In this case, it was necessary to determine whether the requirement of the Conflict of Interests Act that a company should not be owned by a member of the government had been met. It was therefore necessary, in the same way, to also conduct an assessment of these companies, in particular of AGROFERT, a.s..

[156] When assessing the ownership structure of AGROFERT, a.s., it was established that 'all 628 ordinary shares of AGROFERT, a.s., associated with a 100% share in the voting rights and registered capital of the company, was invested in the trusts AB private trust I and AB private trust II'. It was also established which entities held the position of trust administrators. During the checks, the data provided were verified from available public records.

[157] As a further step, it was necessary to assess the legal character of the entity of a ‘trust’, namely, what the legal status is of such an entity and what it actually is.

[158] As provided for in Article 1448(1) to (3) of the Civil Code, effective from 1 January 2014, the creation of a trust 'establishes separate and independent ownership of the part of property set aside' and 'the property in a trust is not owned by the administrator or the founder, or the person entitled to receive a performance from the trust'.

[159] It was therefore necessary, from a legal point of view, to come to the conclusion that
Wotan Forest and NAVOS are owned by AGROFERT a.s., with that company (its shares) not being owned by anyone (there is no owner in the form of a natural person) because the shares of AGROFERT constitute property set aside in a trust and, under the Civil Code, that property is not owned by any entity.

[160] This is the purpose of instituting a trust – the founder of a trust does not have control over that fund/property, in particular within the meaning of the concept of ‘controlled entity’, as used in the Conflict of Interests Act. Conversely, the purpose of a trust is to separate property in the trust from its founder and entrust its administration to a trust administrator. The trust administrator then manages the property in question in practice and could be considered to be the person who actually controls the trust, from both a legal and factual point of view. The founder may only remove the administrator, and only if he/she infringes the administration rules or other requirements while exercising his/her functions under the by-laws of the trust or under legislation. The founder’s influence on the administrator is therefore very limited and applies only where the by-laws or legislation are infringed by the trust administrator. It is therefore not possible to conclude that the trust administrator is a controlled entity, as indicated below. For details see points 16 to 25 of this response.

[161] It was therefore necessary to come to the conclusion that a trust, as a separate and independent ownership, is not a natural person or legal entity per se and is not a commercial enterprise. A trust therefore does not have and cannot be given ‘právní osobnost’ [legal personality] under Article 15 of the Civil Code (this concept used to be known as ‘právní subjektivita’ [legal personality]).

[162] By conducting checks on the applicants, the companies Wotan Forest and NAVOS, it was therefore possible, from a legal point of view, to come to only one legal conclusion: namely, that no public official pursuant to Article 2(1)(c) of the Conflict of Interests Act has an ownership share in the commercial enterprises Wotan Forest and NAVOS (which are given legal personality), nor does any entity controlled by a public official own a share in these commercial enterprises, because the trust – occurring at the end of this property chain, as explained – does not constitute an entity and is not owned by anyone. Moreover, Article 4c of the Conflict of Interests Act relates only to commercial enterprises – it reads that it relates to ‘a commercial enterprise in which a public official as referred to in Article 2(1)(c) or the entity controlled by such a public official owns a share’. However, a trust is not a commercial enterprise (these are, under the Business Corporations Act, public commercial enterprises, limited partnership companies, limited liability companies, public limited companies, European companies and European Economic Interest Groupings), with the result that Article 4c of the Conflict of Interests Act cannot apply to a trust. For details, see the arguments provided in response to finding No 1, i.e., points 19 to 37.

[163] It is obvious that the staff from the legal department of the IB-SFZP fulfilled the obligation to verify the ownership structure under the ENV OP with respect to both projects to the maximum possible extent. As no natural person existed, as the owner, the staff from the IB-SFZP legal department could not have infringed that obligation, as stated by the Commission’s auditors in finding No 4.

[164] Furthermore, the legal department of the State Environment Fund investigated whether AGROFERT could nevertheless be owned by a public official. However, it came to the conclusion, along the lines of the reasoning indicated in points 16 and following, that control which would be relevant for Article 4c was not possible.

[165] It is evident from the above that when checks were conducted into the ownership structure before the grant award decision was issued, the staff from the legal department of the IB-SFZP investigated the extent of a possible conflict of interests with regard to members of
the government and no conflict of interests on the part of any member of the government was identified for either of the two projects. In view of the above, there was no legal reason on the basis of which it would be possible to reject the application.

[166] It should also be pointed out that the Commission's audit report itself states on page 15, point 2, paragraph (1) that Mr Babiš was Minister of Finance from 29 January 2014 to 24 May 2017 and has been Prime Minister since 6 December 2017. This means that at the time when the ownership structure was being examined prior to the issuing of the grant award decision and, in particular, when the grant award decision was issued, Mr Babiš was not a member of the government but a member of the Chamber of Deputies of the Czech Parliament (Article 2(1)(a) of the Conflict of Interests Act).

[167] As indicated in detail above, the dismantling of the ownership structure of AGROFERT ensured that the shares in this company are not owned by any entity. It was therefore not possible to identify any natural person who might have a conflict of interests within the meaning of the prohibition laid down in Article 4c of the Conflict of Interests Act. As a public official, Mr Babiš, who is identified in this report as a natural person having a conflict of interests with regard to the two projects in question for which support was provided and with regard to the implementers of these projects, with respect to which the managing authority for the ENV OP was required to apply the prohibition laid down in Article 4c of the Conflict of Interests Act, was not in the position of being an individual referred to in Article 2(1)(c) of that Act when the legal acts were issued on the provision of support. In the case of both applicants, the grant award procedure, as already indicated in various parts of this response, was launched before Act No 14/2017 came into force, i.e. at a time when the prohibition on providing support under Article 4c of the Conflict of Interests Act was not regulated by legislation. It therefore is not true that the legal department of the SEF did not carry out a proper assessment and did not reach any conclusions regarding any conflict of interests in the case of the two projects and their applicants.

[168] Beyond the framework of the above reasoning, which unequivocally illustrates that the legal department of the State Environment Fund not only verified the ownership structures of the two applicants cited but also inquired into a possible conflict of interests on the part of natural persons, it is unequivocally proven that there has been no breach of the Conflict of Interests Act.

[169] With reference to the above reasoning, the IB-SFZP proceeded in accordance with the law.

In light of the above, we do not agree with finding No 4 and request that it be deleted.

Conclusion of the Commission services:

The finding is dropped.

The auditors acknowledge the procedures in place to verify the absence of conflict of interest of any applicants and the verifications carried out by the Czech authorities specifically related to the above-mentioned two projects.

The auditors note that the grant agreements for the two projects concerned were signed during the period when Mr Babiš was not a member of the government but a member of the Chamber of Deputies of the Czech Republic. Therefore, for the grants awarded to these two operations, the Commission auditors agree that Article 4c did not apply. The two projects are therefore removed from annex 2.b (list of systemic errors in the entire population).
Although the grants to these two operations do not fall under Article 4c, the auditors nonetheless draw the attention of the Czech authorities to the need to ensure that the scope of management verifications to assess whether a physical person (e.g. owner of an entity) is a public official owning a 25% or more of a commercial enterprise (Article 4c of the Conflict of Interests Act) extends to the managers of trust funds and that the checks are properly documented. For the analysis on a possible conflict of interest, the Commission auditors refer to the conclusions under finding 1 above.

As the prohibition concerning the award of grants under Article 4c does not apply in the case of the two above mentioned operations and as the legal department of the IB-SFZP has carried out an analysis of the ownership structure, the finding is dropped.
Finding 05

Key requirement: KR 2 - Appropriate selection of operations

Timing and scope of non-conflict of interest declarations signed by the employees of MA and IB for OP Environment / programming periods: 2007-2013 and 2014-2020

When entering in service and signing their employment contract, the IB-SFZP and MA staff (e.g. internal evaluators/project managers/financial mangers) signed a declaration of independence and a code of conduct.

However, for the programming period 2007-2013, staff were not requested to confirm the absence of conflict of interests prior to the evaluation of a particular project application.

For the programming period 2014-2020, the IT system has been adapted and the staff assigned to evaluate an application must first formally confirm, by ticking a box within the IT system, that they are not in a situation of conflict of interests. However, the auditors could not obtain assurance that by accepting an evaluation task for a particular application, the staff are fully aware of the meaning of a conflict of interests and of the consequences if they unduly accept a task.

Action to be taken / recommendation

The MA/IB should ensure that by ticking the box declaring the absence of conflict of interests before accepting to evaluate an application, staff are made aware of (i) the definition of a conflict of interest and (ii) the consequences for the staff it may have if they unduly accept an evaluation task.

The declarations should only be signed by an evaluator following a review of all information available on both the applicant and the project. The IT system should contain a record of the declarations signed at each stage by each employee.

Importance: Important

Body responsible: managing authority/intermediate body

Deadline for implementation: 3 months

Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[170] The MS2014+ system contains a checkbox for internal users (for internal evaluators in CSSF14+) for the process of accepting an assignment to evaluate a project, which requires them to confirm their impartiality, and thus also exclude a possible conflict of interests. Filling in the checkbox is compulsory and without this confirmation it is not possible to accept the assignment. External users (external evaluators in ISKP14+) are required, after filling in the checkbox, to electronically sign the data, by which they confirm the information.

[171] All evaluators (internal and external) have the option of previewing a project before accepting an assignment (i.e. they have ample information with which to decide whether they can evaluate a project or not, i.e. that they do not have a conflict of interests).

[172] Beyond this measure within the system, we would point out that each managing authority resolves conflicts of interests in the context of the employment relationship between the employer and the employee, whether in the context of a service or employment
relationship. At the same time, the managing authority has put in place its own control mechanisms in connection with a possible conflict of interests.

[173] The risks of an imminent conflict of interests in connection with an applicant/beneficiary of support, i.e. in particular personal, property-related, work-related or other organisational ties with the management and control system for the ENV OP, are dealt with by the relevant provisions of the Conflict of Interests Act and by the internal rules of the State Environment Fund. That Act is transposed by internal guidelines SM 01 Staff Regulations (version 1 of these guidelines came into force on 30 November 2015). Likewise, employees who are not employed under the aforementioned Staff Regulations, but on the basis of Act No 262/2006, the Labour Code, as amended, are bound by the same requirements regarding the risks associated with a conflict of interests under internal guidelines SM 05 Conditions of Employment. The Staff Regulations and the Conditions of Employment, Section 2.1, impose an obligation on all employees to familiarise themselves with these internal guidelines and are made available to them on the intranet of the SEF. All employees must be informed of them when taking up their duties, in the form of mandatory initial training emphasising that, when performing their duties, they must comply with these and at the same time with other internal guidelines and orders of the director. The training is provided by the Staffing and Civil Service Unit. The form of initial training is governed by the Fund’s internal rules on health and safety at work, on training and transport operating rules. The obligation on the part of employees to comply with the legislation relating to their duties, with the Staff Regulations and with orders on the performance of duties, including compliance with the rules arising from the Fund’s Ethics Code, which is annexed to these guidelines, is derived from Chapter 14.2 (Obligations of state employees) of the Staff Regulations and from Chapter 10.2 (Obligations of employees) of the Conditions of Employment.

At the same time, the Fund guarantees the form in which internal rules are published, namely in accordance with internal guidelines SM 04 Regulations, which clearly stipulate in Section 6.4.1 that each internal rule, after being adopted, is published by its competent legal guarantor via the Fund’s intranet in the ‘legislation’ section. A notification about its publication is simultaneously issued to all employees of the Fund by e-mail, thus demonstrably guaranteeing that all employees of the Fund have access to the new or updated rules, including their annexes. All employees of the Fund are obliged to familiarise themselves with the new rules and comply with them under Article 15.2.1. of the Staff Regulations.

[174] When entering into a service or employment relationship, all employees of the IB-SFZP sign an Ethics Code, which forms part of the above-mentioned rules. NB: At the request of the Commission’s auditors, the signed ethics codes of all evaluators involved in evaluating grant applications were transmitted with respect to all the projects audited under the Environment Operational Programme during the discussions. The signed ethics code forms part of the personal file of every employee. Article 6 of the code is devoted to preventing a conflict of interests. Employees also sign a sworn declaration on not undertaking business activity, including not being members of the management or supervisory body of a legal entity pursuing a business activity and not engaging, without the employer’s prior written consent, in any other gainful employment (in accordance with Article 304(1) of the Labour Code and the Civil Service Act). A potential conflict of interests is also dealt with through management verification (approval by managers) and the procedures laid down in the Environment Operational Manual (‘second pair of eyes’ check during evaluations, etc.).

[175] Therefore, if the Commission’s auditors call into question efficiency and/or mention in their draft report that not enough was done to ensure awareness of completing the relevant
field in MS2014+, and add that this was not ensured under the previous programme, we consider this comment to be entirely irrelevant. In light of the above, all those involved in the evaluation and verification processes are properly aware of how to proceed where there is a conflict of interests and impartiality. The above-mentioned box in the IT system should be regarded as going beyond the standard by drawing the evaluator’s attention to the fact that he/she should make certain that in the case of a specific applicant and project there is no potential conflict of interests. The evaluators proceed on the basis of a list of projects made available to them and are able to examine the background information and documents associated with the projects, i.e. to what the application relates and who is the applicant; see above.

[176] At the same time, it should be added that in the context of the ENV OP technical evaluation criteria are used and it is not possible to carry out a subjective evaluation.

[177] The audit did not provide evidence of any conflict of interests on the part of employees of the Ministry of the Environment and of the State Environment Fund. Nor did it provide evidence to show that the system was not functioning properly.

With regard to the above, we do not agree with finding No 5 and request that it be deleted.

Conclusion of the Commission services:

The finding is **dropped**.

*Programming period 2007-2013*

Given that Environment OP for the 2007-2013 period has been closed, no further action is requested in follow-up of the recommendation from the draft audit report.

*Programming period 2014-2020*

The Member State’s reply clarifies that:

(i) The Conflict of Interests Act is transposed by internal guidelines (Staff Regulations);

(ii) The Staff Regulations and the Conditions of Employment, impose an obligation on all employees to familiarise themselves with these internal guidelines and are made available to them on the intranet of the SEP;

(iii) All employees must be informed of them when taking up their duties, in the form of mandatory initial ad-hoc training and

(iv) The evaluators proceed on the basis of a list of projects made available to them and are able to examine the background information and documents associated with the projects, i.e. to what the application relates and who is the applicant.

The auditors acknowledge that the Czech authorities have set up a system to ensure that, by ticking the box declaring the absence of conflict of interests before accepting to evaluate an application, staff are aware of the definition of a conflict of interest and the consequences it may have if they unthinkingly accept an evaluation task. The Commission auditors also note that declarations are signed by an evaluator following a review of all information available on both the applicant and the project.

Based on the above-mentioned clarifications, the finding is **dropped**.
5.2.2.2. Findings on the operations

Finding 06

Lack of audit trail of the decisions taken in the selection process (measure 5.1) / programming period: 2007-2013

For the programming period 2007-2013, in the case of all nine operations sampled for measure 5.1, there is no supporting documentation underpinning the opinion of the Ministry of Environment (Stanovisko MZP) concerning the technical and environmental evaluation of the applications (substantive evaluation stage). This opinion is the main document supporting the substantive evaluation of the applications.

The Ministry of Environment informed the auditors that the two employees who drafted the opinions for these nine projects have since retired. In one case out of the nine (project CZ.1.02/5.1.00/12.16959 - PREOL), the current manager was able to explain how the former employee performed the evaluation and to demonstrate how the opinion given was justified.

The Commission auditors reviewed the annexes to the project application to re-perform the remaining eight substantive evaluations. Based on documentation provided by the Ministry of Environment (i.e. independent expert opinions, feasibility studies, cost estimates) the auditors confirmed that the operations fulfilled the technical and environmental selection criteria and were correctly selected for financing. Some minor differences in the evaluations re-performed by the Commission auditors would not have any impact on the selection of the operations, as there were no minimum number of points required for that measure and all the applications which fulfilled the eligibility criteria were financed.

Moreover, the auditees did not provide the Commission auditors with any benchmark/guidance given to the evaluators on how to assess the selection criteria where the assessment questions were constructed in a general way, for example:

Example 1: Question on the assessment of the level of risk: 3 replies were possible: (i) Project to a large extent contributes to risk reduction; (ii) Project partly contributes to risk reduction; (iii) The project does not contribute to risk reduction.

Example 2: Question 2 on technical criteria: Cost of the project compared to standards and with other projects of similar character is (i) adequate, (ii) more expensive or (iii) too high.

The lack of adequate audit trail reduces the transparency of the selection process.

Action to be taken / recommendation

The 2007-2013 programming period is closed. However, for the current and future programming periods, the Czech authorities should ensure that an adequate audit trail is kept for the evaluation process of future calls, to ensure that all stages of the grant evaluation process are adequately documented and that these documents are readily retrievable.

In order to ensure equal treatment of all applicants, clear guidance should be issued to ensure that evaluators have a common understanding of how to evaluate each selection criterion.

Importance: Very important

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46 CZ.1.02/5.1.00/13.19180 – Ceresa; CZ.1.02/5.1.00/13.20380 – Lovochemie, CZ.1.02/5.1.00/13.19176 – Navos; CZ.1.02/5.1.00/12.17046 – Primagra, CZ.1.02/5.1.00/12.16956 – Synthesia, CZ.1.02/5.1.00/13.20367 – Synthesia, CZ.1.02/5.1.00/11.13433 – VUOS, CZ.1.02/5.1.00/13.19151 – VUOS.
Body responsible: managing authority

Deadline for implementation: next calls for the 2014-2020 programming period and future one

Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[178] Regarding the recommendation relating to finding No 6 we would state the following. In the context of the current programming period for the Environment Operational Programme 2014-2020, measures for reducing environmental risks are supported by SC 3.5 Reducing environmental risks and developing systems for managing them.

[179] Generally speaking, the procedure for evaluating projects, as with the other specific objectives of the ENV OP, is laid down in Part C, Chapter C.2 (Processes and rules for evaluating and selecting projects) of the Rules for Applicants and Beneficiaries (PrŽaP), which are published on the website www.opzp.cz/dokumenty. Any specifications are laid down in the call, which is also published on the website www.opzp.cz. Internal procedures for evaluating projects then form part of Chapter E of the Operating Manual for the ENV OP, specifically Part E.3 (Evaluating applications).

[180] In order to illustrate the audit trail when the Operating Manual is drawn up, we would point out that the Ministry of Regional Development and the Ministry of Finance comment on the Operating Manual. The Ministry of Regional Development and the Ministry of Finance confirm to the managing authority that the consultation procedure has been completed after reaching final agreement; thus they send the managing authority, by electronic communication, their agreement with the way in which all their fundamental comments have been dealt with. All versions of the Operating Manual, including the comments, are kept by the managing authority. The formal requirements and acceptability criteria are laid down in parts of the Rules for Applicants and Beneficiaries, which are approved by the Monitoring Committee of the Environment Operational Programme (specifically, parts B and C.2.1.1). All the evaluation criteria (including any amendments) are also approved by the Monitoring Committee of the Environment Operational Programme. Memoranda from the Monitoring Committee of the Environment Operational Programme are also retained by the managing authority. Minutes including background material are also uploaded and kept in the MS2014+ system. Final minutes are also published on the website www.opzp.cz.

[181] The project application, including the evaluation and complete audit trail, is uploaded and kept for audit trail purposes in the MS2014+ system.

[182] Moreover, in the case of SC 3.5, under the general acceptance criteria (see Chapter B of the Rules for Applicants and Beneficiaries), a positive opinion is required from the competent department within the Ministry of the Environment responsible for environmental risks and ecological damage and limiting industrial pollution. As part of the acceptability checks, the intermediate body which conducts the evaluations, i.e. the State Environment Fund, requests this opinion in writing for every project (by means of a letter to the head of department of the competent unit within the Ministry of the Environment). This written request (letter) from the State Environment Fund includes the bases for the opinion, i.e. in particular the project documentation and a feasibility study. At the same time, the competent member of staff within the Ministry of the Environment has access to the MS2014+ system,
which contains the complete project documentation. The correspondence in question (request for the issuing of an opinion including the opinion of the Ministry of the Environment) is retained both in the filing service of the State Environment Fund and in the filing service of the Ministry of the Environment. Furthermore, the competent evaluator from the State Environment Fund inserts the opinions of the Ministry of the Environment, including any annexes, in MS2014+.

[183] The opinion of the Ministry of the Environment is issued by:

- the Ministry of the Environment’s department of environmental risks and ecological damage – for projects focusing on compensation or the reconstruction of equipment with a view to increasing the safety of operations, decreasing the degree of risk within the framework of EU standards,

- the environmental impact assessment and integrated prevention department – for projects focusing on reconstruction or the purchase of technologies to restrict emissions which pollute the environment and technologies for monitoring industrial pollution of individual environmental compartments.

[184] The opinion of the competent department of the Ministry of the Environment is processed using a verbal descriptor. The standard methodology for evaluating projects to prevent serious risks and the standard methodology for evaluating projects to curb industrial pollution were provided with our reply. The methodologies ensure a consistent approach for the opinions produced by the competent department of the Ministry of the Environment and serve as a basis for evaluating whether applications should be accepted.

In light of the above, we would request that the situation described be taken into account and supplemented for the period 2014-2020. We believe that at the present time the system has been set up adequately and appropriately. In this connection we would also request that the recommendation be deleted.

**Conclusion of the Commission services**

The finding is **closed**.

**Concerning the audit trail**

The Member State reply clarifies that, as regards the 2014-2020 programming period:

(i) the procedure for evaluating projects is laid down in Part C, Chapter C.2 (Processes and rules for evaluating and selecting projects) of the Rules for Applicants and Beneficiaries;

(ii) the project applications, including the evaluation and complete audit trail, are uploaded and kept for audit trail purposes in the MS2014+ system.

(iii) all correspondence (request for the issuing of an opinion including the opinion of the Ministry of the Environment) is retained both in the filing system of the State Environment Fund and in the filing system of the Ministry of the Environment;

(iv) the competent evaluator from the State Environment Fund records the opinions of the Ministry of the Environment, including any annexes, in MS2014+ and

(v) the standard methodology for providing the opinion of the competent department of the Ministry of the Environment is provided in Annex to the Czech reply to the draft audit report.
On this basis, the auditors acknowledge that the Czech authorities have set up, for the current programming period, a system aimed at ensuring that an adequate audit trail is maintained for the evaluation process of calls, that all stages of the grant evaluation process are adequately documented and that these documents are readily retrievable.

Concerning guidance to the evaluators

The auditors acknowledge the clarifications provided by the Member State and consider the internal procedures for evaluating projects, which form part of Chapter E of the Operating Manual for the ENV OP, specifically Part E.3 (Evaluating applications), to be satisfactory, provided that if in the future more subjective evaluations requiring professional judgement are used, adequate instructions on how to assess such criteria should be provided to the evaluators.

On the basis of the above mentioned clarifications, the recommendations related to the audit trail and the guidance to evaluators are closed.
Finding 07

Project CZ.1.02/2.2.00/11.12743 – beneficiary AGRO Jevišovice: Contract awarded to a linked company – programming period 2007-2013

The selection committee of the company (beneficiary of project CZ.1.02/2.2.00/11.12743), acting as a contracting authority, awarded a contract to the company AGROTECHNIC Moravia company. AGROTECHNIC Moravia is owned by NAVOS a.s., which in turn belongs to the AGROFERT Group and since 22 June 2010 is the sole shareholder of AGROTECHNIC Moravia company.

AGROTECHNIC Moravia was selected on 24 February 2012, i.e. before Mr Babiš entered the Czech government. In line with the only criteria (i.e. lowest price), the selection committee of AGRO Jevišovice awarded the contract to the bidder providing the cheapest eligible offer.

The value of the contract (CZK 4,545,000 approx. EUR 176,000) was below the applicable EU public procurement thresholds but fell under the high-value threshold category 1 (‘ZVH I’) of the Czech legislation on procurement. The award of the contract needed to comply with the provision of the Ministry of Regional Development Regulation’s ‘Binding procedures for the award of contracts co-financed by EU resources not covered by Act No 137/2006 on public procurement, in the 2007-2013 programming period’.

The applicable award procedure for contracts with a higher value of category 1 entails the following steps:

(i) seeking a minimum of 5 candidates for the submission of a bid;
(ii) a deadline for submission of bids of at least 15 days from the date of dispatch of the request to submit the offer;
(iii) the setting up of a offers evaluation committee of at least 3 members;
(iv) the drafting of minutes of the meetings signed by the offers evaluation committee, including the recommendation of the most advantageous bid and
(v) informing all bidders on the outcome of the selection procedure and of the conclusion of a contract.

In line with this procedure, the contracting authority (i.e. the beneficiary) requested offers from 5 companies, of which 3 belong directly or indirectly to the AGROFERT group, i.e. NAVOS a.s., AGROTECHNIC Moravia and KVARTO.

Out of the 5 offers requested:

(i) Although the offer of NAVOS, a.s., was the cheapest offer before its exclusion, it was excluded due to lack of fulfilment of the technical criteria;
(ii) The offers sent by ALS AGRO (a company not linked to the AGROFERT Group) and KVARTO (owned by ZZN Pelhřimov a.s., which belongs to AGROFERT Group) were not selected as their offers were more expensive than the cheapest eligible offer;
(iii) AGROSERVIS ZAMEL, s.r.o. did not send any offer (the auditors could not establish whether this company belonged to the AGROFERT Group);
(iv) AGROTECHNIC Moravia was selected in line with the only award criterion (i.e. lowest price).
The award process was in line with the applicable procedure. However, the fact that AGRO Jevišovice, as contracting authority, requested Navos a.s., AGROTECHNIC Moravia and KVARTO to submit an offer may constitute a conflict of interests as these three companies had financial links with AGRO Jevišovice via the AGROFERT Group. This approach is not in line with the principle of sound financial management, in particular with the basic principle of transparency. The offers from three linked companies within the same group as the contracting company cannot be considered as independent offers.

**Action to be taken / recommendation**

The finding relates to the 2007-2013 period. For the future, programme authorities are requested to clarify in the award procedure to require a minimum of 3 to 5 independent offers, meaning from independent, non-linked companies, in line with the principle of sound financial management.

Importance: Very important

Body responsible: Managing authority/intermediate body

Deadline for implementation: 2 months

**Position of the Member State:**

*Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.*

[185] At the outset, we would point out a crucial flaw (discrepancy) in finding No 7 and also in the ‘recommendation’ section. While the finding talks about the contracting authority acting in error by inviting financially linked suppliers to submit a bid, the ‘recommendation’ section states that the responsible entity should ensure that three to five independent bids are required. There is, however, a crucial difference between inviting suppliers to submit a bid and receipt of a bid from suppliers. While the contracting authority is able to issue an invitation for the submission of a bid, the receipt of a bid from suppliers is entirely outside the competence of the contracting authority and it is up to the supplier whether it submits a bid or not. The observations below therefore relate not only to the idea of inviting suppliers to submit a bid but also to the idea of receiving a bid from suppliers. However, we would ask the Commission’s auditors to define their findings and subsequent recommendation in an entirely clear and certain manner, as the responsible entity must know beyond doubt on what it is required to make observations.

[186] In the first instance, we would point out that in this case the contracting authority was not obliged to award the public contract either in accordance with the Act on Public Contracts, in force when the procedure was launched, or in accordance with EU directives governing the award of public contracts which were in force when the procedure was launched. The grant provided to the contract in question represented only 26% of the total eligible expenditure from performance of the contract. All the remaining funds were ultimately covered from the contracting authority’s own resources. If this contract were not cofinanced from European funds, the contracting authority would be authorised to award it directly without conducting any kind of selection procedure. However, as a consequence of the cofinancing, the contracting authority was obliged to proceed in accordance with the ‘Postupy pro ZZ’ [Procedures for the award of contracts] and the ‘Pokyny OPŽP’ [Guidelines of the ENV OP], which incorporate the ‘Postupy pro ZZ’ and elaborate further on the provisions on the award
of public contracts in the ENV OP.

[187] It is also necessary to focus on the period during which the award procedure and checks were carried out by the intermediate body. The award procedure was launched on 6 February 2012, evaluation was completed on 24 February 2012 and the contract was concluded on 8 March 2012. The contracting authority was obliged to issue a call for the submission of bids from at least five suppliers, which it did. Specifically, this concerned the following suppliers: ALS AGRO a.s., AGROTECHNIC MORAVIA a.s., NAVOS FARM TECHNIC s.r.o., KVARTO, spol. s r.o., AGROSERVIS ZAMĚL, s.r.o. The Commission’s auditors state that three of the five suppliers had financial ties with the contracting authority and refer to AGROTECHNIC MORAVIA a.s., NAVOS FARM TECHNIC s.r.o. and KVARTO, spol. s r.o. But not a single one of these companies was owned directly by AGROFERT HOLDING a.s.; in each case second-level ownership was involved, hence ownership through another entity.

Although the commercial register was checked at the time, the first-level owner was an entity other than AGROFERT HOLDING a.s. However, not even the law prohibits entities within the framework of a holding to take part in an award procedure. The participation of entities of this kind is prohibited only in the case of ‘bid-rigging’, or prohibited agreements. At the same time, a prohibited agreement of this kind needs to be proven, and by the competent body, which in the Czech Republic is the Office for the Protection of Competition [Úřad pro ochranu hospodářské soudržnosti]. When proving facts of this kind, a thorough investigation needs to be conducted in order to obtain sufficient evidence. Neither the managing authority nor the intermediate body is the competent body for conducting an investigation of this kind. During the award procedure no doubts arose as to whether a prohibited agreement of this kind had been concluded between interconnected suppliers.

[188] As regards the contracting authority itself, the Commission’s auditors state that it formed part of the above-mentioned holding. However, they did not at all address the question of how information was accessed when checks of the award of the contract were carried out and thus what kind of information the intermediate body was able to obtain. NAVOS a.s., which belongs to the holding in question, became the sole shareholder, and thus 100% owner of the contracting authority, on 29 April 2013 (i.e. more than a year after the award procedure had been carried out and after it had been checked by the State Environment Fund of the Czech Republic). Until that time the contracting authority had been issued with a total of CZK 249.281 ordinary shares in its name. The company (contracting authority) is not obliged to indicate the owners of its shares in the commercial register. When verifying the ownership of the contracting authority, the intermediate body was thus only able to establish that its ownership was held by shareholders with a total of CZK 249.281 shares. The checks were carried out in 2012 and at that time the entities in the implementation structure of the Environment Operational Programme did not have a system which would allow them to establish the ultimate owner, as is now the case with the ARACHNE system. For the sake of completeness, we would point out that the ARACHNE system has only been fully functional since 2016. Therefore, from the sources accessed for administration of the application, it was not possible effectively to establish the actual owner during the relevant period.

[189] In 2014, the Commission also provided the Member State with checklists, which covered, amongst other things, questions relating to verification of the award of public contracts. These checklists were to be a guarantee for the Member States that the checks carried out would be fully in line with EU legislation. However, not one of the questions covered in the checklists provided by the Commission comprises a question regarding verification of a conflict of interests between the contracting authority and the suppliers invited to submit bids. Therefore during the time in question it is evident that not even the

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Commission saw an increased risk with regard to checks concerning conflict of interests.

[190] At the same time, there is the question of whether, when defining the absolute impossibility of participation by entities in a connected group, it is, in the case of the ownership structures of EU commercial entities (the legal form is the European Company), realistically at all possible in practice to verify and evaluate any connectedness. Realistically, even in the case of entities which are multinational groups (e.g. VW, VEOLIA, SUEZ, ARCELOR MITTAL, ASSA ABLOY), it is impossible in practice to conduct an evaluation on such a scale entirely objectively as part of a review.

[191] It may therefore be presumed that at the time when the checks were carried out the managing authority/intermediate body acted in accordance with all available measures and rules. As the Commission’s auditors themselves state, the award of the public contract took place in accordance with the applicable procedures; moreover, the timing of the procurement procedure does not fall within the scope of the Financial Regulation 2012.

[192] As regards the recommendation, the Commission’s auditors request that the responsible entity ensures that the contracting authority receives bids from three to five independent and financially non-linked entities. However, a request of this kind is entirely at variance with national and European legislation, as it is not within the contracting authority’s remit to decide on what kind of bids it receives. Only the suppliers themselves may decide on whether to submit a bid or not. A decision of this kind depends solely on their free will. The ENV OP therefore demands that the above-mentioned finding and, in particular, the recommendation be deleted.

Reaction of the entity overseeing Act No 137/2006 on public contracts in the Czech Republic and the ‘Procedures for the award of contracts’

[193] This finding brands as incorrect the approach taken by the contracting authority AGRO Jevišovice, forming part of the AGROFERT group, which invited three companies, also forming part of the AGROFERT group, to submit bids and ‘only’ two companies which do not form part of the AGROFERT group.

[194] The evaluation criterion was the lowest bid price.

[195] According to the Commission, the fact that the contracting authority also invited bids from companies which formed part of the same business group as itself could create a conflict of interests and the bids from these companies cannot be considered to be independent bids.

[196] In view of the fact that, in the case of this contract, as mentioned above, there is no public contracting authority, it is evident that implementation of an in any way simplified award procedure in which the contracting authority will select the cheapest bid cannot be branded as ‘not in line with the principle of sound financial management’.

[197] The recommendation runs counter to Czech and EU legislation, specifically to the Public Procurement Act (ZZVZ) and to Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC, which this Act transposes into Czech law. Directive 2014/24/EU does not contain any provisions on the basis of which it would realistically be possible to fulfill the requirement of submitting a minimum of three to five bids. If contracting authorities were to apply them, this would be a direct breach of the Directive in question.

[198] From the point of view of the legal regulation of public procurement, European law primarily envisages reaching out to suppliers without addressing them specifically (and inviting them to participate in a competition). The Commission’s requirement that contracting authorities invite a specific number of unconnected entities to submit bids is not in keeping
with this approach.

Moreover, the Commission’s recommendation is distinctly at variance with the decision-making practice of the CJEU, which, given that the case investigated has a similar purpose, may be applied mutatis mutandis in connection with the regulation of the provision of grants.

In its judgment in Case C-21/03 (Fabricom SA), the CJEU ruled that national legislation automatically excluding a legal person from a procedure for the award of a contract, ‘where that person has not been given an opportunity to prove that, in the circumstances of the case, the experience which he has acquired was not capable of distorting competition’, runs counter to EU regulatory provisions on the award of public contracts.

In Case C-213/07 (Michaniki AE) the CJEU concluded that the list of grounds for exclusion from the procurement procedure was exhaustive. The CJEU did not allow that the status of owner, partner, main shareholder or management executive of an undertaking active in the media sector was incompatible with that of a public contractor by means of an irrefutable presumption. According to the CJEU, an undertaking should have the opportunity to prove that there has been no distortion of competition or impairment of transparency.

According to the CJEU, national legislation of this kind under which certain suppliers are to be automatically excluded (without being able to prove that there has been no breach of public procurement rules) therefore runs counter to European legislation on the award of public contracts. The Commission’s recommendation that only unconnected legal entities be invited to submit bids (thereby automatically excluding connected legal entities) runs counter to this interpretative practice of the CJEU.

That is all the more so in view of the decision-making practice of the CJEU as regards in-house procurement. The CJEU established the premise that, when carrying out the tasks entrusted to it, a public contracting authority may use its own administrative and technical resources, including where they are formally allocated to a special legal entity. See, for example, the judgment in Case C-107/98 (Teckal).

Moreover, in a situation where the sole evaluation criterion is the lowest bid price, it could hardly be thought that inviting, inter alia, connected entities to submit bids could somehow distort the results of the evaluation of the bids and thus the results of the procurement procedure.

In light of the above, we do not agree with finding No 7, or with the recommendation, and request that they be deleted.

Conclusion of the Commission services:

The finding is maintained.

The auditors reiterate that in the present case, no financial correction is requested as the award process was in line with the applicable procedure and that at the time when the checks were carried out (i.e. in 2012) the managing authority/intermediate body acted in accordance with all available measures and rules.

The Commission auditors also acknowledge that this particular procedure was not an open call for tenders and take note that the cheapest offer was selected.

However, for the sake of sound financial management and transparency, for the future procurements carried out by private companies acting as contracting authorities, the contracting authorities should consider seeking a minimum of 5 to 5 (depending on the
national legislation) candidates for the submission of a bid, which should be independent and financially not linked to the contracting authority.

Therefore, the recommendation is **open**.

**Importance:** Very important  
**Body responsible:** Managing authority/intermediate body  
**Deadline for implementation:** 2 months
5.2.3. Enterprise and Innovation for Competitiveness OP (CCI 2014CZ16RFOP001) – Programming Period 2014-2020

Please note that KR 2 - Appropriate selection of operations was reviewed also during REGIO’s Early Preventive System Audit mission no REGC414CZ0018 carried out from 20 to 24 February 2017. The system findings detected by REGIO's Commission services during the EPSA mission no REGC414CZ0018 are also relevant for this audit. The purpose of this mission is not to repeat the findings already communicated by the Commission services to the Czech authorities in the Final audit report (ref: no Ares(2017)4403176 of 08 September 2017). Therefore, for the findings detected earlier, we refer to that audit report. Nevertheless, partial overlaps are possible, where there are new elements.

The Commission services identified the system deficiencies listed in the following findings.

5.2.3.1. KR2 - System findings

Finding 08

Key requirement: KR 2 - Appropriate selection of operations

Selection criteria not sufficiently defined

Under Article 110 of the CPR, the monitoring committee shall examine and approve the methodology and criteria used for selection of operations.

The selection criteria for Call for operations no 01_15_014 Innovations were approved by the monitoring committee on 28 May 2015. However, the methodology and selection criteria were not sufficiently defined. There was no guidance on what aspects should have been taken into account by the evaluators during the operation evaluation or on how the information provided in the operation application should have been assessed and points allocated. See also findings 15.

This led to numerous cases, where the MA EIC needed to use a third expert (32% of all operations assessed during the substantive evaluation), where one expert recommended an operation for financing and the second expert did not. In some cases the difference in points assigned was more than 40 points out of a total possible of 100 points (e.g. operation no CZ.01.1.02/0.0/0.0/15_014/0000245 ‘Inovace medových výrobků’ – first evaluator assigned 29 points, the second evaluator 73 points and the third evaluator 43 points).

Action to be taken / recommendation

Recommendation

The MA EIC should ensure for all future calls for operations under the 2014 – 2020 OP EIC that the methodology and the selection criteria are clearly defined and that adequate instructions and training are provided to evaluators.

Importance: Very important

Body responsible: OP EIC managing authority

Deadline for implementation: 2 months
Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[205] We do not agree with the finding and propose that it be omitted. Finding No 8 relates to applications for support/projects under the programme INNOVATION – Innovative project and concerns the evaluation and selection of projects. Prior to making observations on the finding, we would therefore provide some basic information about the programme, in particular about the evaluation criteria.

[206] When the programme documents – both the text of the INNOVATION – Innovative project programme and its calls and their annexes – were drawn up they were largely based on the programme documents of the preceding programming period 2007-2013, i.e. the Operational Programme Enterprise and Innovation, and on the experience gained from administration of applications for support and likewise from the projects themselves from this programming period.

[207] The definition of the activities to be supported was based on the ‘Oslo manual OECD 2005’, which provides not only a breakdown of the types of innovation but also a clear definition of innovation, indicating that the minimum requirement for innovation is that the product, process, marketing or organisational method be new (or significantly improved) for the firm.

[208] In the same way, when preparing not only the programme and its calls but also the evaluation criteria for the programme, use was primarily made of the documents from the Operational Programme Enterprise and Innovation, with the evaluation criteria being based on a study conducted by the Technology Centre of the Czech Academy of Sciences. The main difference from the preceding programming period concerned the criterion which assesses the degree of innovation from the point of view of technical parameters. The reason for this change was largely to make the evaluation method more objective and reduce the degree of subjectivity, although it is impossible to eliminate that completely in the case of research, development and innovation projects. The criterion concerning the degree of innovation from the point of view of technical parameters was thus assessed anew in line with Professor František Valenta’s publication entitled ‘INOVACE v manažerské praxi’ [INNOVATION in managerial practice]47, who broke down innovation into innovation rankings.

[209] The evaluation method (procedure, matching of expert opinions, etc.), which is laid down in MS2014+ is based on the Single Methodological Environment (JMP). The procedures followed by the selection committee are based on the Statute of the selection committee of the managing authority for the Operational Programme Enterprise and Innovation for Competitiveness (OPEIC), which is annexed to the OPEIC Operational Manual (OM OPEIC).

[210] Now to the actual finding. According to the audit finding, the evaluation criteria are not sufficiently defined, nor is there any guidance on what aspects should have been taken into account by the evaluator when evaluating the project or on how the information provided in the application for support should have been assessed and points allocated. This assertion is based on the fact that in the case of 32% of projects evaluated under Call I it was necessary to bring in a third independent evaluator, known as an evaluation arbiter. In arguing that the evaluation criteria are not sufficiently defined, the auditors refer to the extreme difference in the case of project CZ.01.1.02/0.0/0.0/15_014/0000245 (0000245), where the first evaluator

assigned 29 points, the second evaluator 73 points and the third evaluator (arbiter) 43 points.

[211] We cannot agree with the assertion that the evaluation criteria are not sufficiently defined. The evaluation criteria were defined in line with the valid methodology of the Operational Programme Enterprise and Innovation for Competitiveness (OPEIC) (OPEIC Operational Manual), also based on the Single Methodological Environment (JMP). The method for evaluating the projects was subject to the approach laid down in the MS2014+ system and was entirely in accordance with the method prescribed for matching expert opinions and with the methodology laid down for using arbitration evaluation. Annexed to Call 1 were the selection criteria, which are broken down into binary (eliminatory) criteria and points-based criteria. In the case of binary criteria, where it is not immediately evident from the name of the criterion, a comment is always provided giving more specific information on the criterion in question and a source of information for the evaluation. In the case of points-based criteria, there is always a direct indication of the cases to which a specific number of points is allocated, a comment providing more specific information, where it is not immediately evident from the name of the criterion, and also a source of information. The selection criteria for call for projects No 01_15_014 Innovation were adopted by the monitoring committee on 23 May 2015. Representatives of the Commission took part in the monitoring committee’s discussions.

[212] The criteria for evaluating projects under the Horizon 2020 programme, directly managed by the Commission, which are markedly more general than in the programme INNOVATION – Innovative project and do not include quantifiers may be a supporting argument for our assertion that the selection criteria are sufficiently well defined. Evaluation under the Horizon 2020 programme is based on the predominant expert evaluation, there being a wide spread of expert opinions. Despite this evaluation model being designed in this way it may not be characterised as insufficiently definite and the direct management of the Horizon 2020 programme cannot be considered to be high-risk. Conversely, the more general nature of the criteria in the field of application of the results of science and research is generally regarded as more appropriate.

[213] The general nature of the evaluation criteria under the Horizon 2020 programme can be illustrated by the wording of one of the criteria: ‘Extent that proposed work is ambitious, has innovation potential, and is beyond the state of the art (e.g. ground-breaking objectives, novel concepts and approaches).’ and by the instructions for awarding the number of points for this criterion, where the difference between the evaluations ‘Good’ and ‘Very good’ consists of ‘minor shortcomings’ unspecified in advance.

**Scoring**

Scores must be in the range 0-5. Half marks may be given. Evaluators will be asked to score proposals as they were submitted, rather than on their potential if certain changes were to be made. When an evaluator identifies significant shortcomings, he or she must reflect this by awarding a lower score for the criterion concerned.

**Interpretation of the scores**

0 — The proposal fails to address the criterion or cannot be assessed due to missing or incomplete information.
1 — Poor. The criterion is inadequately addressed, or there are serious inherent weaknesses.
2 — Fair. The proposal broadly addresses the criterion, but there are significant weaknesses.
3 — Good. The proposal addresses the criterion well, but a number of shortcomings are present.
4 — Very Good. The proposal addresses the criterion very well, but a small number of
shortcomings are present.
5 — Excellent. The proposal successfully addresses all relevant aspects of the criterion.
Any shortcomings are minor.

Thresholds
The threshold for individual criteria is 3. The overall threshold, applying to the sum of the three individual scores, is 10.

[214] In the Operational Programme Enterprise and Innovation for Competitiveness, the criterion for assessing innovativeness is defined more precisely. First the exclusion criteria and then the C criteria, which focus on the need for and relevance of the project:

<table>
<thead>
<tr>
<th>A. Exclusion criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. In the area of project innovation or process innovation, the project reaches at least Valenta innovation ranking 5(^{48}) for SMEs and at least Valenta innovation ranking 6 for large companies.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Title</th>
<th>What remains</th>
<th>What changes</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>-n</td>
<td>Degeneration</td>
<td>Nothing</td>
<td>Loss of characteristics</td>
<td>Wear and tear</td>
</tr>
<tr>
<td>0</td>
<td>Regeneration</td>
<td>Object</td>
<td>Renewal of characteristics</td>
<td>Servicing, repairs</td>
</tr>
</tbody>
</table>

**RATIONALISATION**

<table>
<thead>
<tr>
<th>1</th>
<th>Quantitative change</th>
<th>All characteristics</th>
<th>Frequency of factors</th>
<th>Other workforce</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Intensity</td>
<td>Quality and connection</td>
<td>Speed of operations</td>
<td>Acceleration of a production belt</td>
</tr>
<tr>
<td>3</td>
<td>Reorganisation</td>
<td>Qualitative characteristics</td>
<td>Division of activities</td>
<td>Shift of operations</td>
</tr>
<tr>
<td>4</td>
<td>Qualitative adaptation</td>
<td>Quality for users</td>
<td>Connection to other factors</td>
<td>Technological construction</td>
</tr>
</tbody>
</table>

**QUALITATIVE CONTINUOUS INNOVATION**

<table>
<thead>
<tr>
<th>5</th>
<th>Variation</th>
<th>Construction solution</th>
<th>Partial quality</th>
<th>Faster machinery</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>Generation</td>
<td>Construction design</td>
<td>Construction solution</td>
<td>Electronic machinery</td>
</tr>
</tbody>
</table>

**QUALITATIVE DISCONTINUOUS INNOVATION**

<table>
<thead>
<tr>
<th>7</th>
<th>Variety</th>
<th>Technological principle</th>
<th>Construction design</th>
<th>Jet loom</th>
</tr>
</thead>
<tbody>
<tr>
<td>8</td>
<td>Genus</td>
<td>Affiliation to strain</td>
<td>Technological principle</td>
<td>Hovercraft</td>
</tr>
</tbody>
</table>

**TECHNOLOGICAL REVOLUTION – MICROTECHNOLOGY**

| 9       | Strain                | Nothing                | Access to Genetic    |

<table>
<thead>
<tr>
<th>What is the product innovation ranking on the Valenta scale? (will be evaluated only if the product innovation activity is implemented)</th>
<th>Number of points</th>
<th>Source of information</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Project corresponds to innovation ranking 9</td>
<td>15</td>
<td>Ž, PZ</td>
</tr>
<tr>
<td>• Project corresponds to innovation ranking 8</td>
<td>13</td>
<td></td>
</tr>
<tr>
<td>• Project corresponds to innovation ranking 7</td>
<td>11</td>
<td></td>
</tr>
<tr>
<td>• Project corresponds to innovation ranking 6</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td>• Project corresponds to innovation ranking 5</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td>• Project corresponds to innovation ranking 4</td>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>

Information required for the evaluation:
• Business plan
• Other relevant documents

[215] There is therefore no reason for evaluation under the INNOVATION programme to have been considered high-risk, as the evaluation criteria under the INNOVATION programme are more precise and more stringent than under the Horizon 2020 programme, managed directly by the Commission. Although not entirely unusual, in the case of project 0000245, there was an extreme difference in points. It is not clear in what connection mention is made in this audit, which evidently focuses on a conflict of interests on the part of AGROFERT a.s., of project 0000245 of the MARLENKA International, s. r. o., which does not form part of the AGROFERT group. If it is right to assume a connection with the 2017 audit (reference made at the start of the audit report on the Operational Programme Enterprise and Innovation for Competitiveness (OPEIC)), finding No 8 should be supplemented with a check to determine whether the recommendations from the 2017 audit were complied with or not. However, this check does not form part of the audit report and one therefore has to wonder why this specific project, and ultimately the entire evaluation process, is mentioned in the audit report.

[216] However, based on the results of the 2017 audit to which reference is made, a substantial adjustment was made – across the OPEIC support programme priority axis I – to the selection criteria annexed to the call, this annex being renamed ‘Model evaluation and criteria for evaluating and selecting projects’ [Model hodnocení a kritéria pro hodnocení a výběr projektů] and discussed during the seventh meeting of the monitoring committee on 28 February 2017 and at the eighth meeting of the monitoring committee on 6 and 7 June 2017. The material change consisted of a clear indication of the procedures when evaluating projects (check of admissibility and formal requirements, substantive evaluation, selection of projects and issuing of the grant award decision); furthermore, in the case of most binary and points-based criteria, the comments were expanded and the source information for the evaluation was fleshed out. On the basis of the document ‘Model evaluation and criteria for evaluating and selecting projects’, which is always publicly accessible on the websites of the grant provider and intermediate body, an Evaluator’s manual for evaluating applications for support (for the substantive evaluation) was drawn up and the Methodology for evaluating the
financial viability of projects (economic evaluation) was updated. The internal and external evaluators were trained by experienced staff from the intermediate body, who were involved in drawing up the Model evaluation and criteria for evaluating and selecting projects and in the manual and methodology referred to above. Both these documents including the presentation of the programme call were always issued to the evaluators undergoing training. The purpose of the training was to familiarise evaluators with the evaluation procedures and with the evaluation criteria in the programmes in question. The training also included lectures on implementation of the RIS3 strategy. The table below shows the structure of one of the training sessions:

<table>
<thead>
<tr>
<th>Time</th>
<th>Programme</th>
</tr>
</thead>
<tbody>
<tr>
<td>8:35-8:45</td>
<td>Registration/launch</td>
</tr>
<tr>
<td>08:45-9:30</td>
<td>'Innovation' programme (presentation + questions)</td>
</tr>
<tr>
<td>09:30-10:15</td>
<td>'Potential' programme (presentation + questions)</td>
</tr>
<tr>
<td>10:15-10:45</td>
<td>Economy of the budget, structural part of the budget</td>
</tr>
<tr>
<td>10:45-11:30</td>
<td>'Application' programme (presentation + questions)</td>
</tr>
<tr>
<td>11:30-12:00</td>
<td>'Infrastructure services' programme</td>
</tr>
</tbody>
</table>

[217] Likewise, the Ministry of Industry and Trade is clearly capable of providing evidence of the training carried out for evaluators.

[218] Priority axis 1 of the Operational Programme Enterprise and Innovation for Competitiveness focuses on R&D&I and the focus of the applications for support often moves in uncharted territory; it may therefore be concluded that the expert may have a different opinion on the direction of research. An essential requirement of R&D&I is the element of uncertainty and novelty. The currently preferred direction in which developments are moving does not have to be acceptable after just a few months. The opinions of experts can differ widely, thanks to which R&D&I is expanding and branching out in many directions, with unique new solutions thus developing, which at the outset might have caused scepticism and appeared unrealistic to some. For this reason, it is often the case that two evaluators disagree and the situation described in the audit report arises. This is why an arbiter is used, who expresses his/her views on the matter with his/her third independent opinion and thus tends towards one or the other side.

For the above reasons, the managing authority rejects the recommendation in finding No 8, as the recommended measures have already been introduced under the Operational Programme Enterprise and Innovation for Competitiveness.

Conclusion of the Commission services:

The finding is maintained and further clarified as follows.

The Commission services take note of the explanations of the Czech authorities that selection criteria were defined and used in line with the valid methodology for selection of operations under the OP EIC. Nevertheless, the Commission services identified weaknesses related to the methodology and the selection criteria themselves and the way in which they were applied.

The auditors maintain that the methodology and selection criteria related to innovation are not sufficiently detailed and are outdated in parts.
The selection criteria for the Call for operation no 01_15_014 as well as for the Call for operation no 01_17_109 are based on the Valenta scale of innovation49 (i.e. for the assessment of novelty of innovation / novelty of the resulting product).

The use of Valenta scale, which was developed almost 20 years ago and is used in a simplified way by the Czech authorities, is not considered as current ‘best practices’ for the assessment of enterprises and the level of innovations being achieved by them. In order to establish clear and objective guidelines for the assessment of applications, it is recommended to use a scale enabling the assessment of innovation to be based on consistent criteria, using current knowledge and up-to-date solutions. Therefore, for the selection process for OP EIC it would be more appropriate to use a regularly updated Oslo Manual and the Commission definitions rather than the Valenta scale of innovation.

The following examples were noted in this regard:

- A table presented in the Annex no 4 (Selection criteria) of the Call for operations no 01_15_014 and the Call for operation no 01_17_109 and also presented in the reply of Czech authorities to the draft audit report which over-simplifies the Valenta scale.

- For the Call for operation no 01_15_014 and the Call for operation no 01_17_109 it was noted that Level 6 innovation on the Valenta scale was given for the use of machines with electronics. This level does not appear appropriate as currently it is difficult to imagine a modern machine that does not have any digital or electronic devices.

- A number of the terms used such as ‘accelerated belt’, ‘faster machine’, ‘machine with electronics’ or ‘a jet blast’ are somewhat outdated in that they are not very nuanced or precise.

- The definition of innovation provided by the Oslo Manual was also simplified as regards particular requirements. For example, innovation should differ significantly from the firm’s previous business process50.

- Often, the evaluators did not record a justification for their assessments. Written explanations were not recorded for many of the selection criteria as assessed as having been fulfilled. During the Commission audit the evaluators were unable to remember or explain their reasons for having awarded particular points.

Therefore, the process for the evaluation of applications lacks transparency and evaluators have a very broad level of discretion when carrying out their assessments. This increases the risk of selection of ineligible projects, including projects not having the minimum level of innovation. The present audit identified a number of such cases (See findings 15 and 19).

Therefore, the managing authority should give clear guidance and training to evaluators on the proper application of the methodology to avoid such cases recurring in the future.

As concerns the training of the internal/external evaluators, the Member State’s reply explained that the purpose of the training was to familiarise evaluators with the selection procedures and the selection criteria used in the particular calls. The training also included

49 Valenta, František, Inovace v manažerské praxi. Velryba, Prague 2001

50 According to the Oslo Manual: ‘a product innovation is a new or improved good or service that differs significantly from the firm’s previous goods or services and that has been introduced on the market. A business process innovation is a new or improved business process for one or more business functions that differs significantly from the firm’s previous business processes and that has been brought into use by the firm’. 
lectures on implementation of the RIS3 strategy. In this regard, the Commission services acknowledge that some training was provided. However, given the wide range of topics to be covered, the amount of actual training provided is considered as insufficient.

In conclusion, the recommendation that the MA EIC should ensure for all future calls for operations under the 2014 – 2020 OP EIC that the methodology and selection criteria are clearly defined, including providing adequate instructions to evaluators in the framework of high quality training remains open.

Importance: Very important
Body responsible: OP EIC managing authority
Deadline for implementation: 2 months
Key requirement: KR 2 - Appropriate selection of operations

**Verification of ownership structure not carried out for large enterprises**

The Commission auditors noted that the managing authority limited their verifications of the ownership structure of applicant companies only to SMEs and did not verify this aspect for large enterprises. This was due to a focus on the compliance of SMEs with State aid rules rather than for conflict of interests purposes.

When assessing the ownership structure of the applicant, the Czech authorities relied on the information submitted in the applicant’s self-declaration (‘T2A_2_F_Prohlášení k žádosti o podporu’). Where the applicant declared itself to be a large enterprise, the MA EIC / IB API did not perform any checks of the ownership structure or on the beneficial owner of the applicant, as this was not relevant for any increased co-financing rate which was only available to SMEs (i.e. for Call II for Energy savings the EU co-financing rate represented 50% for small enterprises, 40% for medium enterprises and 30% for large enterprises).

Correspondence between the intermediate body and the applicant (‘Interni depeše’) shows that the intermediate body treated the submission of the self-declaration as a formality and did not verify it 51.

The Commission takes note that the related methodology for the in-depth verifications of ownership structure for SMEs is in force since 1 January 2018. Since then the ARACHNE tool is also used. However, this new methodology does not include any verification of the ownership structure of large enterprises.

The partnership agreement states in chapter 2.5:

> ‘The aim for the 2014-2020 programming period is to minimise the risk of occurrence of fraud and corruption behaviour by establishing suitable preventative measures, mechanisms for detecting fraud and preventing its recurrence [...]. The following were identified as main problem areas: selection and evaluation of operations, awarding public tenders, carrying out control activities and setting up management processes for individual parties involved in the implementation.’

> ‘With respect to the transparency principle and to prevent potential conflict of interests, applicants will be obliged to disclose their ownership structure based on the proportionality principle according to the methodological guideline specifying the area of financial flows when submitting their grant applications or during the operation selection process. Applicants at risk of conflict of interests or who will not be able to prove their ownership structure will be excluded.’

Therefore, ownership structure should be verified to identify potential conflict of interests.

In this regard, the Commission services noted that the beneficial owner mentioned in the grant applications for operations (see footnote 13) submitted within the Call for operations no 01_16_061 (Energy savings) does not correspond to the beneficial owner mentioned in the Statute of AB private trust I and II. The beneficial owner specified in the applicant’s self-declaration (‘T2A_2_F_Prohlášení k žádosti o podporu’) was the trustee of these funds. As indicated in finding no 1, the Commission services consider that Mr Babiš is the beneficial

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51 Operations No CZ.01.3.10/0.0/0.0/16_061/0011139, CZ.01.3.10/0.0/0.0/16_061/0011143, CZ.01.3.10/0.0/0.0/16_061/0011152, CZ.01.3.10/0.0/0.0/16_061/0011875 and CZ.01.3.10/0.0/0.0/16_061/0011988
owner of the AB private trust I and II. This issue was not identified by the management verifications.

**Action to be taken / recommendation**

Recommendation 09.01

The programme authorities are requested to review the ownership structure for all types of beneficiary, including large enterprises, at least on a sample basis and to specify in their methodology a procedure for the selection of applicants who would be requested to submit supporting documents proving their ownership structure including the beneficial owners. It is recommended to carry out this selection based on a risk assessment. However, an element of randomness should also be considered.

In this respect, the programme authorities are also recommended to consider obliging applicants/beneficiaries, at the time of submission of the application or before the grant agreement is signed, to provide details of the ownership structure in order to ensure that sufficient information is available for the subsequent risk analysis.

In addition, the OP methodology should also include sufficient instructions explaining how verification of the ownership structure shall be carried out, taking into account risks related to this area (e.g. several layers of the companies, companies from abroad), specifics of different types of companies and requirements set in the relevant EU and national legislation.

As from now, the programme authorities are requested to review the ownership structure up to the level of the ultimate beneficial owner, in particular in the case of trusts but also for subsidiaries to the large groups.

Recommendation 09.02

As a significant number of operations have already been selected, the Czech authorities are requested to verify the ownership structure of all large enterprises selected to date to ensure that any conflict of interest issues are identified.

Importance: Very important

Body responsible: OP EIC managing authority

Deadline for implementation: 2 months

**Position of the Member State:**

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[219] This finding conflates two areas. Admittedly, both of them deal with the question of ownership structure, but the legal basis and the objectives sought are completely different.

[220] The methodology for SME status verification genuinely contains a provision stating that there is no need to verify SME status in the case of entities declaring themselves as large enterprises. This provision is correct, since large enterprises do not derive any benefits or advantages from their status.

[221] Any checks on conflict of interest are a completely different subject, with a different legal basis. Large enterprises are by no means excluded from the obligation to report the data in accordance with Article 14(3)(e) of Budgetary Rules in the applicant’s self-declaration
Furthermore, with regard to calls published from mid-2018 onwards, the MA introduced a ‘transparency package’, containing measures aimed at enhanced transparency and conflict of interest prevention, e.g. Call IV. for the Energy Savings programme [https://www.agentura-api.org/wp-content/uploads/2018/07/Uspory-energie_IV-vzvza.pdf, bod 4.2, letters (g), (h) and (i)].

One of these measures (related to the setting up of the Record of Beneficial Owners) is the obligation of the applicants to have their beneficial owners entered in this record. We are attaching the relevant part of the internal MA OP EIC analysis of this measure, containing detailed information and references to the relevant legislation.

We would emphasise that the MA OP EIC displays its own initiative in continuously upgrading the programme’s management and control system, frequently beyond statutory obligations. Currently, the obligatory entry in the Record of Beneficiary Owners is in the legislative process as a draft amendment to Act No 218/2000 (Budgetary Rules). Nonetheless, the MA OP EIC has already implemented this measure, thus being ahead of the legislative process by more than a year. We would point out that a proposal for new and more stringent regulations on the Record of Beneficiary Owners has already entered the legislative process.

The MA OP EIC is acting in line with the provisions of Chapter 2.5 of the Partnership Agreement and the methodological guidance for financial flows [MPFT], chapter 5.1.1. Mandatory particulars of a decision to award the grant (points 22 and 23). These MPFT provisions were later incorporated into the decision to award the grant wording by the MA OP EIC.

In addition, we would emphasise that all operations referred to in the audit report in footnote 15 had been registered before the amended Act No 253/2008 introducing measures to combat the laundering of proceeds from criminal activities and the financing of terrorism entered into force.

Thanks to the introduction of the ‘transparency package’, the MA OP EIC meets the recommendations in 09.01. Therefore, the MA considers the current configuration of the management and control system to be sufficient and does not agree with finding and recommendation 09.01. For the same reasons, the MA disagrees also with recommendation 09.02.

We do not agree with the finding and we request its withdrawal, including the withdrawal of both recommendations.

Conclusion of the Commission services:

The recommendation is maintained and further clarified as follows.

The Commission services clarify that the finding relates to the verification of ownership structure in relation to the obligation of the Member state to put in place control systems to be capable of avoiding conflict of interests only (i.e. not SME status). The Commission services have already communicated the procedure for the verification of the SME status to the Member state. This position remains unchanged.

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52 Article 32(3) of the Financial Regulation 2012 and Article 36(3) of the Financial regulation 2018
The Commission services acknowledge the Member State’s reply provided in point 220 and agree that there is obviously no need to verify the SME status of the applicant in case of entities declaring themselves as large enterprises.

The Commission services note that the obligation for disclosing and evidencing the ownership structure up to the level of beneficial owner was already included in the Methodological guidance for financial flows from 1 September 2016. Following this guidance, managing authorities were obliged to ensure that applicants have submitted, with the project application, a list of beneficial owners in the form of a declaration of honour. The applicant/beneficiary has to provide further supporting documents as regards beneficial owners to the MA, CA, AA, European Court of Auditors (hereafter ‘ECA’) or the Commission upon request.

The Commission services welcome the adoption of the transparency package, which means:

- that since June 2018 the MA EIC has started to request all applicants under the OP EIC to register their beneficial owners in the Register of beneficial owners, which is maintained by the ‘registrar court’ in accordance with Act No 304/2013 Coll., on the Public Registers of Legal and Natural Persons and on the Register of Trusts and;

- that since June 2018 it is not possible to award a grant to an applicant whose beneficial owners are not disclosed in the Register of beneficial owners.

Nevertheless, the Commission services understand from the Member State’s reply that the Czech authorities consider that it is not necessary for the MA EIC to carry out any additional verifications of the ownership structure apart from checking against the Register of beneficial owners. The Commission services disagree with this approach and maintain their position that the MA EIC should verify the ownership structure for all types of beneficiaries, including large enterprises, on a risk basis, at the latest before grant approval, for the following reasons:

- In accordance with Article 118c of the Act No 304/2013 Coll. the Register of beneficial owners is not a public register. Therefore, the correctness of the data in the register can only be verified by persons and public authorities listed in Article 118g of the Act No 304/2013 Coll.

- In accordance with Article 118h of the Act No 304/2013 Coll., the ‘registrar court’ registers information about the beneficial owner only based on the application for registration of information about the beneficial owner. It does not have the obligation to verify already registered information ‘ex officio’.

Therefore, to ensure the correctness of the disclosed data, especially in cases where a long period has elapsed between the date of registration of the beneficial owner in the register and the date that the extract is taken from the register, the MA EIC should verify, on risk basis, if it has any doubts, and using other tools such as ARACHNE, that there has been no change in the ownership structure in this period.

The Czech authorities submitted in their reply extracts from the Register of beneficial owners for both Trust funds. The data downloaded from the Register of beneficial owners by the

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33 On 1 January 2017, Act No 304/2013 Coll. was amended by Act No 368/2016 Coll, incorporating the obligations resulting from the AML Directive in relation to beneficial owners into the Czech law. In accordance with the amendment, a Register of beneficial owners was established from 1 January 2018.
Czech authorities identified as the beneficial owner the trustees only. It clearly shows that the data related to the operations listed in the footnote are incomplete.\textsuperscript{54}

The Commission services do not agree that operations specified in the footnote of the finding were submitted before the amendment to Act No 253/2008 Coll, on selected measures against legitimisation of proceeds of crime and financing of terrorism, which specifies who is the beneficial owner of the trust funds. This amendment (i.e. Act No 368/2016 Coll.) was effective since 1 January 2017. The date of the submission of the grant applications was between July and October 2017 and the approval of operations was between January 2018 and May 2018.

The following recommendations are maintained and further clarified as follows:

Recommendation 09.01

The programme authorities are requested:

- to review the ownership structure in relation to conflict of interest for all types of beneficiary using the extract from the \textit{Register of beneficial owners}, including large enterprises.

- where, based on other available sources of information, they have doubts about the completeness of the data in the \textit{Register of beneficial owners}, they should consider requesting additional supporting documents from the applicant proving their ownership structure, including the beneficial owners.

Programme authorities are also requested to review the ownership structure up to the level of the ultimate beneficial owner in the case of trusts and subsidiaries of large groups to identify any conflict of interest issues.

Recommendation 09.02

As a significant number of operations have already been selected and have not been subject to detailed verification as regards conflict of interest issues, the Czech authorities are requested to verify the ownership structure of all large enterprises selected to date based on information now held in the \textit{Register of beneficial owners} with a view to identify potential conflicts of interests.

\textbf{Importance: Very important}

\textbf{Body responsible:} OP EIC managing authority

\textbf{Deadline for implementation:} 2 months

\textsuperscript{54} Operations No CZ.01.3.10/0.0/0.0/16_061/0011139, CZ.01.3.10/0.0/0.0/16_061/0011143, CZ.01.3.10/0.0/0.0/16_061/0011152, CZ.01.3.10/0.0/0.0/16_061/0011187 and CZ.01.3.10/0.0/0.0/16_061/0011988
Finding 10

Key requirement: KR 2 - Appropriate selection of operations and KR 4 - Appropriate management verifications

Risk assessment at operation level – lack of procedures for the identification of risky operations at the selection stage and their later verification during management verifications

The Commission services noted that the internal or external evaluators raised during the selection of operations certain concerns/risks with potential impact on the operation implementation. However, this information was not recorded and used for the risk analysis of the operation for the purposes of planning on-the-spot checks by the MA EIC.

For example, for the operation no CZ.01.1.02/0.0/0.0/15_014/0000516, one of the internal and one of the external evaluators listed certain risks during the operation evaluation and commented that these elements should be incorporated into the grant agreement as a condition for co-financing from the EU funds and checked during operation implementation. However, this information was not included in the grant agreement or later used by the MA EIC / IB API for their management verifications.

Action to be taken / recommendation

Recommendation 10.01

The MA should set up a system where the risks identified during the selection of operations are recorded, stored and followed up in the later stage during the management verifications at all levels (i.e. MA EIC / IB API).

Recommendation 10.02

The MA EIC is requested to verify all cases where the evaluators identified risks / conditions for funding and carry out appropriate management verifications in relation to these cases.

Importance: Very important

Body responsible: OP EIC managing authority

Deadline for implementation: 2 months

Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[228] With regard to finding No 10 we would point out that, where an external or internal evaluator has any reservations or doubts, these are stated in the final comment on the project evaluation. If this is the case, the reservations are dealt with by a selection committee composed of at least three independent members. The reservations in the final comment of the evaluators are analysed at the meeting of the selection committee and are taken into account in its decision, which is one of the following: recommendation/ recommendation subject to a reservation / non-recommendation of the project for funding. It is within the competence of the selection committee to request the evaluator to explain their argumentation or to return the evaluation to the evaluator for further explanations. With regard to the reservations stated, the selection committee may also reduce the project's proposed budget or request the submission of proof of the funding of the project, or request the submission of other relevant documents.
With regard to project CZ.01.1.02/0.0/0.0/15_014/0000516 we would point out that it was evaluated by two evaluators, of whom only one expressed certain unspecified reservations. For clarity, please find the full text below:

The evaluation of the internal evaluator is based on the evidence and recommendations of an external expert. In most cases, it is possible to agree with these. These differences have no impact on the overall outcome of the evaluation.

The subject of the project proposal is to enhance the technical value and the effectiveness of the toast bread production technology and to enhance the utility value of new products (removal of preservatives, reduction of the salt content, extended shelf-life, improved flavour characteristics). The essence of the project proposal is to acquire a line with innovative elements to make it possible to produce new products (own original wheat mash, 3 new kinds of heel-less toast bread). All binary exclusion criteria were met. The general technical capacity of the applicant is good, apart from certain reservations arising from the vivid description of the shortcomings, as stated in the application. The applicant demonstrated a good knowledge of comparable solutions. Certain doubts exist as to whether certain important functional characteristics (in particular salt content) will be complied with in the final product.

Innovation

The parameters of the final product (toast bread with a reduced salt and preservatives content and an extended shelf-life) make it a global frontrunner, constituting a 6th grade innovation as a new generation according to Valenta.

The assessment of the innovative character of the process according to Valenta is based on the fact that the technological progress (as described in the business plan) can be characterised as a new design solution and also as an electronically equipped machine. Contrary to the external judgment, a 6th grade innovation is therefore recognised.

Cost-effectiveness

While one could share the external expert's view that the project is not one of the cheapest, no major deviations from standard prices were found on examination. Similarly, there is a clear differentiation between the various kinds of project expenditure, including a detailed breakdown of eligible and ineligible expenditure. The expenditure proposed is required for the implementation of the project and is linked to the project activities.

No major deviations from standard prices were found. Similarly, there is a clear differentiation between the various kinds of project expenditure, including a detailed breakdown of eligible and ineligible expenditure. The expenditure proposed is required for the implementation of the project and is linked to the project activities.

Conclusion: Despite certain partial shortcomings and reservations, the project is characterised by a good economic potential and return. Therefore, it can be recommended for financing if the means are sufficient.

Application CZ.01.1.020.00.015_0140000516 is recommended for approval.

[230] The MA OP EIC takes the view that in this case the evaluator raised no clearly identified or specified shortcomings or reservations. Furthermore, the second assessment did
not identify any reservations whatsoever. The evaluation of the economic and financial feasibility of the project is that *The project’s economic indicators are within the recommended boundaries, the net present value and the financial level of return are very good... The project’s sources of financing are clearly and unambiguously indicated. The self-financing amount and the amount of the investment loan.* [sic].

[231] In line with the above, Annexes No 23 and 24 contain no statements on the part of the evaluators to the effect that certain risk elements should be included in the legal act (i.e. the grant award decision). In this regard - if the finding is upheld - we request that such declarations/statements in the evaluations of the evaluators be clearly identified.

[232] As has been stated above, at its meeting the selection committee identifies potential risks on the basis of evaluations submitted by the evaluators and requests the applicant to submit further documents; with regard to cost-effectiveness, the committee may reduce the budget or may refuse to recommend the project for financing. In this regard, we believe that MA OP EIC procedures (the *de facto* double verification of the evaluators’ evaluations by the approver and subsequently by the selection committee) ensures sufficient control and prevents/detects any risks in the project. The procedure set up by the MA OP EIC is sufficient. We consider it superfluous to include the statements of the evaluators and the recommendations for the grant award decision, since - as we have stated above - these arguments and recommendations are dealt with by the selection committee and they are handled prior to the issue of the grant award decision.

[233] Under the recommendation in question, the MA OP EIC requests clarification as to where the evaluators’ statement concerning project No CZ.01.1.02/0.0/0.0/014/0000516 states ‘*that those elements should be incorporated into the grant agreement as a condition for co-financing from the EU funds...*’. With regard to findings 10.01 and 10.02, the MA OP EIC would indicate that potential risks related to projects are addressed at meetings of the selection committees, by means of requesting additional documents, by reducing the project’s budget and by refusing to recommend the project for financing. Projects are monitored during the whole implementation phase, as well as following its completion. In the event of potential issues or other findings, it is possible to perform an on-site inspection as part of the checks, in order to determine the actual project status. We believe that there is no need for the proposed record of risk information. At the same time, with regard to the above, we do not believe there to be a need for the suggested verification of all cases where risks or similar were identified, given the quality of the grant procedure in place.

We do not agree with the finding and we request its withdrawal.

**Conclusion of the Commission services:**

The recommendation is **partly maintained** and further clarified as follows.

The Commission services note that the Czech authorities consider the current system related to the risk assessment of the operations at the selection stage for the purposes of management verifications to be sufficient.

However, the Commission services do not agree with this position.

The Czech authorities in their reply [c.f. points 229 – 230] state that the evaluation sheets of the internal evaluators do not contain any statements that certain risk elements should be included in the legal act. The Commission services clarify that they did not refer in their

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55 Draft audit report No REGC414CZ0133 p. 34 of the Czech translation.
observation related to the project no CZ.01.1.02/0.0/0.0/15_014/0000516 to the evaluation sheet of the evaluator 2207. The Commission services refer to the email of 15 December 2016 sent by evaluator 2207. This email was issued in reply to the request of the selection committee of 26 October 2016 to explain certain conclusions made in the evaluation. The email was addressed to a member of the selection committee. The internal evaluator 2207 provided the following information:

'According to the internal evaluator, the characteristics are sufficiently described and indicators to ensure the control of the performance of product innovation in the form of:

- The production of a minimum of 3 types of new products with innovative characteristics
- The removal of preservatives (0 % of preservatives)
- Reduction of salt content — Health protection — the replacement of the kitchen salt (NaCl) with other chloride (values: reduction of 10 %)
- Extension of the shelf-life (a minimum storage of 13 days or more)
- Improvement of the taste - increase in product palatability based on subjective sensory measurement
- Change/improvement of the porosity of the product
- Different weight of products

when, in particular in terms of control of execution, the following elements are important:

- The removal of preservatives (0 % of preservatives).
- Extension of the shelf-life (a minimum storage of 13 days or more).

which the selection committee may apply as a condition of the approved grant as regards the degree of product innovation.'

While it is true that this information has not been included in the evaluation sheet of the internal evaluator, it was transmitted to at least one member of the selection committee. In addition, the risk related to the salt content of the final product was also highlighted by the external evaluator. Therefore, the Commission services consider that the risks were brought to the attention of the selection committee and that they should have been taken into account for the risk analysis of the project.

Therefore, the Commission services reiterate that such risks related to the implementation of the projects should be properly recorded, kept and followed up during the management verifications.

Therefore, the recommendation is maintained and further clarified as follows:

The MA should ensure that the risks identified during the selection of operations and not yet solved at the time of grant award, are recorded, stored and followed up in the later stage during the management verifications at all levels (i.e. MA EIC / IB API).
Importance: Very important
Body responsible: OP EIC managing authority
Deadline for implementation: 2 months
Finding 11

Key requirement: KR 2 - Appropriate selection of operations

1. **Inadequate evaluation of criterion ‘Cost-effectiveness of budget’ (hospodárnost rozpočtu) – unequal treatment of operations**

The Commission services identified a weakness in the evaluation of the criterion ‘cost-effectiveness of the budget’ in relation to 5 operations implemented by the beneficiary Cerea, a.s. The purpose of this criterion is to assess whether the operation budget corresponds to market prices (i.e. whether the budget corresponds to the normal and standard prices).

Based on a methodology for the verification of market prices, the MA EIC compares the official registers of standard prices (available mainly for items in construction works) or indicative offers from the potential suppliers submitted by the applicant.

In line with the methodology, where a technology supply is part of the operation, the applicant should present the indicative offers from the potential suppliers in the grant application, if such indicative offers exist. At the same time, the operation must include a detailed description of the technology to be purchased, including the technical specification and a breakdown of the price.

Annex 3 (‘Evaluation model and criteria for evaluation and selection of operations’) to the call for applications 01_16_061 provides that:

> ‘In this category, the evaluator assesses the intention of the applicant and compares it with specific actions within the operation; assess whether the proposed costs correspond to the operation and whether they are reasonable at place and time to price. The budget of the operation shall include a detailed breakdown of eligible and non-eligible expenditure. The proposed expenditure must be necessary for the implementation of the operation and must be linked to the activities of the operation. Costs must reflect the principles of effectiveness and efficiency.’

If the evaluator considers that the operation budget is excessive, a reduction should be suggested. However, neither the methodology for the verification of market prices, nor the evaluation criteria, nor other available documentation provides instructions to the applicants/evaluators on:

- how many indicative offers should be presented;
- how the price from indicative offers should be considered for the ‘cost-effectiveness of the budget’ (the lowest price or the average price); and
- how to treat a conflict of interests in the case of indicative offers.

The Commission services was informed that the lowest price resulting from the submitted indicative offers is considered for the ‘cost-effectiveness of budget’. However, in some cases, (no examples were provided by the MA EIC) the MA EIC can take into account the average price. Based on a review of the audited operations, the Commission services identified the following:

- In the case of three audited operations (CZ.01.3.10/0.0/0.0/16_061/0011143, CZ.01.3.10/0.0/0.0/16_061/0011152 and CZ.01.3.10/0.0/0.0/16_061/0011875), an average price was used (i.e. calculated as an average from the submitted indicative offers for the technology part);
- In operation no CZ.01.3.10/0.0/0.0/16_061/0011988 a price higher than average was used;
- For operation no CZ.01.3.10/0.0/0.0/16_061/0011139 the highest indicative offer was taken into account.

Moreover, for the same operation an ineligible amount (154,964,40 CZK or approx. EUR 6,006) was identified and deducted. However, this deduction was not taken into account for the assessment of the criterion ‘cost-effectiveness of budget’.

The observations identified above clearly show that there was not a consistent approach on how to evaluate the criterion ‘cost-effectiveness of budget’. As a consequence, this led to unequal treatment of the applicants as the indicative offers were evaluated differently in each application.

Moreover, the person responsible for verification of the criterion ‘cost-effectiveness of budget’ is different from the evaluator for the rest of the application, which is not in line with the methodology of the MA EIC.

Finally, the evaluator should also ‘assess whether the budgeted costs are in line with the action’ under the criterion in question. However, the Commission services noted that this assessment is not carried out by the MA EIC at all.

2. Inadequate evaluation of Criterion ‘Cost-effectiveness of budget’ (hospodářnost rozpočtu) – non existing rules for indicative offers

The Commission services identified that for all applications submitted by the applicant Cerea, a.s. within the Call II for Energy savings, the indicative offers were submitted by only two companies (Commercial společnost s.r.o. and Farmtec a.s.), and in case of operation no CZ.01.3.10/0.0/0.0/16_061/0011988 also by the company AGROING BRNO s.r.o.

The company Farmtec, a.s. is a subsidiary of Agrofert a.s. The applicant Cerea, a.s. is also subsidiary of Agrofert a.s. As indicated under the point 1 of this finding, in the Call for operation rules, there are no procedures on how to treat a conflict of interests for the indicative offers submitted. The MA EIC explained that there is no risk for the EU budget in relation to the indicative offers, as the real price results from the tender procedures.

The Commission services do not share the position of the MA EIC for the following reasons:

- At the selection stage for all operations of the Cerea, a.s., the indicative offers submitted by the company Farmtec a.s. were always higher than the offers submitted by the companies Commercial společnost s.r.o. or AGROING BRNO s.r.o. (i.e. both companies do not belong to the AGROFERT group). For example in the case of operation no CZ.01.3.10/0.0/0.0/16_061/0011988, the difference between the offer submitted by Farmtec a.s. and Commercial společnost s.r.o. was 69%. The difference between Farmtec a.s. and AGROING BRNO s.r.o. was 32%. Therefore, this system allows for artificial increase of the budget of the operations.

- At the later stage of the selection of supplier, neither the company Commercial společnost s.r.o. nor AGROING BRNO s.r.o. were requested to submit a bid in the tender procedure described in finding 12. This approach is not in line with the principle of sound financial management.

Moreover, the Commission services also identified that the applicant Cerea, a.s. was represented during the selection process and the operation implementation by a representative of the company Farmtec, a.s. However, the representative of the Cerea, a.s. for the purposes of the operation was indicated in the project application. This indicates non-transparency of the whole process as Farmtec, a.s. (including its employee ) participated in creating the prices for the operation in question.
Therefore, the indicative offers presented by Farmtec a.s. should not be taken into account by the MA EIC/IB API as offers provided by independent suppliers. It is evident that Farmtec a.s. closely cooperated during the preparation and implementation of the operations in question.

Action to be taken / recommendation

Recommendation

The MA EIC should ensure that indicative offers are provided by independent companies and that they are reasonable compared to market prices. In addition, the MA EIC should assess whether the proposed type of costs corresponds to the operation.

The MA EIC is requested to ensure that a minimum number of offers (e.g. 3 to 5 offers) are submitted from contractors independent of the procuring company, in line with the principle of sound financial management.

Importance: Very important

Body responsible: OP EIC managing authority

Deadline for implementation: 2 months

Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[234] It must be emphasised that the procedure followed in the audited case was in line with the applicable national and EU legislation and within the limits of the methodological environment. The legislation does not stipulate that the lowest offer submitted must be accepted when evaluating the cost-effectiveness of the budget. If this were required by the operational programme, then it would be an instance of 'goldplating'. The draft audit report says nothing about who should have provided that kind of information in the context of the audit or with regard to which specific call.

[235] Evaluators from the relevant service took the view that the standard price was a price within the range of the bids submitted, which is reflected in the evaluation of the projects in question.

[236] Given the diversity of projects and their objectives (which in certain cases focus on totally different areas), it is impossible to set up a uniform averaging of indicative offers for determining the budget or cost-effectiveness of the project under the individual programmes. There are programmes that feature technologies or other unique and specific services, or where the installations involved are continuously upgraded, improved or developed. Subsequently, in the context of the long-term administration of the projects it is necessary to ensure that grant beneficiaries can adapt to this tendency more flexibly when procuring such installations or technologies. At the same time, the indicative offers submitted are not always presented in such detail in the technical specification, or do not need to be in strict accordance with the service provision required. Therefore the price of the requested service selected under the selection procedure may vary (may be higher than the average of the indicative offers) where the model in question is more modern etc. If the project budget were to be set uniformly and calculated on the basis of the average of the indicative offers, then the applicants could theoretically collect an even greater number of differing price offers with
regard to certain simple and easily available tools (such as CNC machines, milling machines) and submit to the MA OP EIC only the indicative offers in the top price level, which also could result in budget distortions. If project budgets were set on the basis of the average of the indicative offers submitted, it could happen (due to project management taking more than a year) that the service price serving as a basis for the indicative bids submitted increased in the meantime and the grant beneficiary could find themselves in a situation where, in the context of a selection procedure, they were unable within the approved MA OP EIC budget to acquire the required service at the price level corresponding to the grant amount, not even under competitive or market conditions.

[237] The priority basis for evaluating the cost-effectiveness of the construction works is the itemised budgets priced in the price systems of the RTS and URS companies.\(^5\) These databases contain pricelists for construction works and materials, expressing the price that is normal on the market in the given space and time. These databases are routinely used by construction companies when pricing their contracts. The databases contain both current pricelists, as well as pricelists from the preceding periods. Updates take place twice per year. BuildPower or Kros+ software is used for budget control. A comparison of the prices in the budget and the prices in the database will detect any overpricing or savings in the budget, as compared to the usual market prices.

[238] In the case of technologies in respect of which it is impossible to submit a detailed itemised budget, the internal evaluators focus on the bids submitted by the applicant. The applicant acquired these items on the basis of a preliminary market survey or during preceding projects of a similar character. These offers were verified by public sources, or compared with technologies characterised by similar parameters. Where more bids were provided, an average was calculated, i.e. the average of items of comparable bids; then, the bid price requested in the project was compared to that price. Where it was impossible to unambiguously break down the bids into detailed items, the accepted price was within the range of the bids.

[239] Furthermore, with regard to project CZ.01.3.10/0.0/0.0/0/16_061/0011988, we would state the following:

Provision of cumulative budget in a grant application

<table>
<thead>
<tr>
<th>A</th>
<th>PART A Documentation related to implementation - ZV [způsobilé výdaje - eligible expenditure]</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ZV - Documentation related to implementation, engineering</td>
</tr>
</tbody>
</table>

Summary part A Total - PART A Documentation related to implementation 50 000

<table>
<thead>
<tr>
<th>B</th>
<th>PART B Technology - delivery, assembly, dismantling - ZN</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ZV - DISMANTLING</td>
</tr>
<tr>
<td>B.II</td>
<td>ZV - TECHNOLOGY</td>
</tr>
<tr>
<td>B.III</td>
<td>ZV-ELECTRICITY</td>
</tr>
<tr>
<td>B.IV</td>
<td>ZV - GAS CONNECTION</td>
</tr>
<tr>
<td>B.V</td>
<td>ZV - TRANSPORT AND HANDLING</td>
</tr>
<tr>
<td>B.VI</td>
<td>ZV - ASSEMBLY AND COMMISSIONING, INCLUDING SOFTWARE</td>
</tr>
</tbody>
</table>

\(^5\) The companies in question are 21[sic] RTS a.s. and URS CZ a.s.
[240] 3 offers were submitted under the project. It was possible to unambiguously identify and compare the principal item, i.e. the highest financial value item, i.e. ‘Dust chamber drying machine’.

<table>
<thead>
<tr>
<th>Summary part B</th>
<th>Total PART B Technology - delivery, assembly, dismantling</th>
<th>6 210 334</th>
</tr>
</thead>
<tbody>
<tr>
<td>PART C CONSTRUCTION WORKS FOR TECHNOLOGY INSTALLATION - ZV</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C.I</td>
<td>ZV - CONSTRUCTION WORKS</td>
<td>497 619</td>
</tr>
<tr>
<td>C.II</td>
<td>ZV - GEODETIC WORKS</td>
<td>5 000</td>
</tr>
<tr>
<td>Summary part C</td>
<td>Total - PART C - Construction works for technology installation</td>
<td>502 619</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Price for ‘Dust chamber drying machine’</th>
<th>Offer No 1</th>
<th>CZK 4 843 000.00</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price for ‘Dust chamber drying machine’</td>
<td>Offer No 2</td>
<td>CZK 6 416 000.00</td>
</tr>
<tr>
<td>Price for ‘Dust chamber drying machine’</td>
<td>Offer No 3</td>
<td>CZK 3 792 000.00</td>
</tr>
</tbody>
</table>

[241] Therefore, the average price for a ‘Dust chamber drying machine’ is CZK 5.017.000.

[242] The price sought in respect of a ‘Dust chamber drying machine’ in the grant application is CZK 4.795.000. In other words, in this regard the price is below the average of the prices in the offers submitted.

[243] Furthermore, the submission of the budget for the electricity and gas connection (priced in the RTS/ÚRS database at CZK 862.364 and 79.970) was also part of the price for the abovementioned technology.

[244] On the basis of these comparisons it was concluded that the itemised budget attached to the grant application was not too expensive and corresponded to the usual market price.

[245] The construction works (CZK 502.619) were also priced in the ÚRS database and compared by means of the Kros+ software. No budget overpricing was detected in this case, either.

[246] The remaining items in the budget (such as dismantling, assembly, transport etc. account for some 10% of the price of the ‘Dust chamber drying machine’ technology, which is in line with the general practice.

[247] In other words, the evaluation of cost-effectiveness detected no indications of overpricing; the approach taken with regard to assessment was identical to the one taken with regard to other applicants. The MA OP EIC does not agree with the view that the price used in the grant application was the price from the highest price offer.

[248] Furthermore, with regard to project CZ.01.3.10/0.0/0.0/16_061/0011139, we would state the following:

[249] Under this project and as part of the argumentation in the introduction to the reaction to this finding, the price of the higher offer was accepted in the budget of the grant application. Records of selection procedures carried out in respect of similar technologies in 2014-2015, provided by the applicant, were taken into account. In each selection procedure there were five suppliers (files Průzkum trhu_ceny sušáren_2014.xls, Průzkum trhu_ceny...
sušáren_2015.xls). On the basis of these selection procedures it is apparent that the differences between the highest and the lowest price for one specific piece of equipment vary between approximately 700,000 and 5 million in 2014 (and therefore also 2015) and approximately 400,000 and 2 million in 2015 (and therefore also 2016.) It is apparent that the price of these installations fluctuates, but the individual bids converge over time. The difference between the offers under the project in question is some 340,000 (which is not even remotely as big as the difference between the amounts in the implemented selection procedures). The higher price was therefore accepted. This price cannot be exceeded and is expected to be reduced in the course of the selection procedure.

[250] In cases where ineligible expenditure has been detected in the project budget, such expenditure was deducted from the total eligible expenditure. They were not compared to the standard prices. Reductions in ineligible expenditure had no impact on the scoring.

[251] With regard to persons responsible for evaluating the cost-effectiveness criterion of the budget, a change was made in the operational programme and Annex D.1_M a D.03_M was updated and issued under the Operating Manual, with effect from 12 June 2019, when both external and internal experts are identified.

[252] With regard to Cerc a.s. project CZ_01.3.10/0/00/16_061.061.0011988 we would state the following: The Rules for Applicants and Beneficiaries (general part, p. 17 subchapter Access to the project) state that the grant beneficiary may grant responsibilities (authorisations) in respect of the project to other users. In this case, the grant recipient availed themselves of this opportunity and, in addition to the attorney [ ] (also in the role of project manager, editor and signatory), also designated [ ] as another signatory and [ ] as editor. It is precisely this editor who - in accordance with their function - is able to save changes. In this regard, we fail to observe any non-standard or non-transparent procedures. With regard to the submission of indicative offers we would point out that three indicative offers were submitted by various companies. The indicative offer submitted by Farmtec, a.s. was processed by [ ]. Since the winner was TIS - CR, s. r. o. rather than Farmtec, a.s., we fail to perceive any advantage conferred upon Farmtec, a.s.

[253] With regard to the indicative offers we would point out that the procedures concerning conflict of interest with regard to requesting and submitting indicative offers are not determined under the Partnership Agreement (unlike conflict of interest affecting large enterprises); nor are they part of any legislation that would be binding upon the MA. Similarly, even the draft audit report makes no reference to any documents where such procedures would be specified.

The reaction of the administrator of Act No 137/2006 on public procurement

[254] Both parts of the finding concern the handling of indicative offers and the rules for taking them into account when submitting the project application, rather than the offers in the tender procedure or selection procedure.

[255] For its part, the Procurement Law Department can say the following with regard to the following complaint of the Commission (p.39 of the Audit report): 'At the later stage of the selection of supplier, neither the company Commercial společnost s.r.o. nor AGROING BRNO s.r.o. were requested to submit a bid in the tender procedure described in finding 12. This approach is not in line with the principle of sound financial management.'

[256] In this context we would point out that it does not follow from the guidance documents governing the selection of suppliers for tenders under co-financed projects that the contracting authority is obliged to invite those suppliers to submit offers whose indicative offers had been used when drawing up the project.
[257] The same would also apply under the Public Procurement Act. In no other type of procurement procedure (such as the simplified ‘under the threshold’ procedure) is the contracting authority obliged to invite the suppliers with whom the preliminary market survey was performed to submit an offer. On the contrary, such an approach would likely be considered as being against the law and discriminatory with regard to suppliers that the contracting authority has not yet contacted.

[258] As regards the recommendation that the MA OP EIC ensure that a minimum number of offers (e.g. 3 - 5) be submitted by companies independent of the contracting authority, it is unclear whether the Commission is referring to indicative offers or offers in the selection procedure. If the Commission recommends that the minimum number of offers in the selection procedure be regulated, then from the perspective of the administrator of public procurement procedures it is necessary to object to that, as such a requirement has no grounding whatsoever in applicable EU or Czech legislation. Since there is no similar regulation with regard to contracts governed by procurement directives and the Czech Public Procurement Act, it is even less applicable to contracts that are not affected by the directives or the Procurement Act. Furthermore, we would emphasise that the contracting authorities or the MA OP EIC are scarcely in a position to influence the number of economic entities interested in obtaining contracts.

We do not agree with the finding and we request its withdrawal.

Conclusion of the Commission services:

The finding is partly maintained and further clarified as follows.

The Commission services take note of the explanations provided by the Czech authorities in their reply [234 – 238] that the evaluators considered as the standard price a price within the range of the indicative offers submitted.

The Czech authorities consider the system in relation to indicative offers as sufficient. However, the Commission services would like to underline that the selection process of the OP EIC shall, according to the Article 125(1) and (3)(a)(ii) respect the principle of sound financial management, principles of non-discrimination and transparency. Selection of operations procedure needs to be transparently set, including the consequent way how the indicative offers are treated for the assessment of the criterion ‘cost-effectiveness of the budget’.

With regard to operation CZ.01.3.10/0.0/0.0/16_061/0011988 [239 - 247] the Commission services would like to clarify that this operation was incorrectly referred to in the draft audit report instead of operation CZ.01.3.10/0.0/0.0/16_061/0011152. The Commission services acknowledge the explanations provided for operation CZ.01.3.10/0.0/0.0/16_061/0011988.
For the operation CZ.01.3.10/0.0/0.0/16_061/0011139, the highest indicative offer was taken into account for the criterion 'cost-effectiveness of the budget' as confirmed by the Czech authorities in their reply. This demonstrates that the evaluation of the criterion 'cost-effectiveness of the budget' is not applied consistently.

One of the indicative offers submitted by Cerea a.s to support its proposed project budget was from Farmteec, a.s. [252 – 253] which is an Agrofer group company. The Commission services therefore consider, in the context of ensuring sound financial management, that there is a risk that the indicative offer may have been overstated. This general risk was also noted by the MA EIC under point 236 of the Member State’s reply.

As stated under finding 12 of this audit report, only one offer was submitted in each of the five tender procedures launched by the beneficiary Cerea, a.s.\(^{57}\) Therefore, it is justified to question the beneficiary as to why suppliers, who presented indicative offers, were not also contacted for the tender procedure.

The fact that there is no obligation in the OP EIC rules or national law to invite suppliers who presented indicative offers for the preparation of the application, does not mean that all the CPR requirements (i.e. Article 4(8) and Article 125(1)) are correctly addressed. Moreover, it should be in the interest of the beneficiary (contracting authority) to contact all the suppliers who submitted indicative offers to ensure that a sufficient number of bids are received in the tender procedure (i.e. launched outside the public procurement law).

Therefore, part of the recommendation in relation to indicative offers is maintained and further clarified.

The Commission services take note of the explanations provided by the Czech authorities presented in points 258 – 259 of their reply in relation to the minimum number of indicative offers to be presented in the grant application.

Further, the Commission services also acknowledge that, as it is not possible to control the actual number of tenderers submitting offers, the recommendation requesting the MA EIC to ensure that a minimum number of offers (e.g. 3 to 5 offers) are submitted from contractors independent of the procuring company is dropped.

The Commission services acknowledge as well that ineligible expenditure is deducted from project budgets. Therefore, the part of the recommendation referring to the assessment of whether the proposed type of costs correspond to the operation is closed.

The recommendation that the MA EIC should ensure that indicative offers, to the extent possible, are obtained from independent companies and that they are reasonable compared to market prices is open.

Importance: Very important
Body responsible: OP EIC managing authority
Deadline for implementation: 2 months

\(^{57}\) Within operations no CZ.01.3.10/0.0/0.0/16_061/0011139, CZ.01.3.10/0.0/0.0/16_061/0011143, CZ.01.3.10/0.0/0.0/16_061/0011152, CZ.01.3.10/0.0/0.0/16_061/0011875 and CZ.01.3.10/0.0/0.0/16_061/0011988
5.2.3.2. KR 4 - System findings

Finding 12

Key requirement: KR 4 - Appropriate management verifications

**Conflict of interests between the contracting authority and the supplier:**

The IB API detected a potential conflict of interest during its verification of the tender procedures within operations no CZ.01.3.10/0.0/0/16_061/0011134, CZ.01.3.10/0.0/0/16_061/0011152 and CZ.01.3.10/0.0/0/16_061/0011988 launched by the beneficiary Cerea, a.s., between the Cerea, a.s. (acting as contracting authority) and the winning company TIS – CR s.r.o. (not member of the AGROFERT group).

The beneficiary Cerea, a.s. is a private company. However, the basic principles of transparency, equal treatment and non-discrimination are transposed into the detailed binding national 'Rules for selection of suppliers' and are applicable to such companies.

A Vice-Chairman of the Board of Directors of Cerea, a.s., is a brother of an executive of the limited liability company TIS – CR s.r.o., which won the 3 tenders within the three operations. The company TIS – CR s.r.o. was the only bidder in these tenders.

All three contracts with the company TIS – CR s.r.o. were signed on 18 April 2018. On 2 July 2018, the IB API concluded that the beneficiary had breached point 55 of the 'Rules for the selection of suppliers' in force since 2 May 2017.

In accordance with point 55 of the above mentioned Rules:

> "the contracting authority shall refrain from any action, which could lead to a conflict of interest in the award and performance of the public contract, in particular at the time of the preparation of tender documents, during the evaluation of the bids, when the contract is signed."

There is a conflict of interest where for the family reasons, for reasons of emotional ties (such as a close person under Article 22 of Act No 89/2012 Coll., the Civil Code), for reasons of economic interest (...) or for reasons of other common interest, the impartial and objective performance of the contracting authority’s activities in tender procedure is compromised. Where such a risk exists, the contracting authority/entity shall refrain from doing so and shall notify the MA without delay. The MA decides whether or not there is a conflict of interest."

The IB API concluded that there is a conflict of interest and proposed 100% financial correction.

On 20 July 2018 the contracting authority terminated all three contracts with the winning bidder and on 25 July 2018 launched three new tenders. The contracting authority again published the tender procedure on its website profile and in addition contacted 5 potential bidders by email. One of the contacted bidders was again company TIS – CR s.r.o. Similar to the initial tender procedure, only one bid by the company TIS – CR s.r.o. was submitted for each of the three tenders.

The IB API was later requested by the beneficiary to provide its opinion on whether the contract with the winning bidder, company TIS – CR s.r.o. could be signed. [REDACTED], a head of department in the IB API, replied on 21 September 2018 to the beneficiary, represented by the same employee of Farmteč a.s. as in finding 11, that the MA OP EIC opinion was being sought. On 11 October 2018, the same person, [REDACTED], that time in the position of the Head of Unit in the MA agreed with the signing of the contract. [REDACTED] in his email of 11 October 2018...
addressed to the IB API explained that by repeating the tender and performing extra effort to receive more bids; the beneficiary did maximum for the transparency of the tender. Nevertheless, the contract signature took place already on 21 September 2018, i.e. before a formal decision was taken by the MA EIC.

For the two remaining operations implemented by Cerea, a.s. no CZ.01.3.10/0.0/0.0/16_061/0011139 and CZ.01.3.10/0.0/0.0/16_061/0011875, the potential conflict of interest due to the family links explained above was not detected by the staff of the IB API. Therefore, the contract between Cerea, a.s. and TIS – CR s.r.o. was never terminated and the issue of potential conflict of interest was never raised for these two operations. This also demonstrates the unequal quality of procedures within this IB API (previous staff of the IB API did not detect this issue).

Commission auditors do not agree with the conclusion of the MA EIC of October 2018 to go ahead with the signature of the contract with TIS – CR s.r.o. due to the following reasons:

- When re-launching the procedure, the beneficiary again directly contacted TIS – CR s.r.o. which was subject to the conflict of interest;
- Another 4 companies (BEDNAR FMT s.r.o., JK Machinery, s.r.o., PAWLICA, s.r.o. and Kovodružstvo, výrobní družstvo Strážov) contacted by the beneficiary did not submit a bid;
- The beneficiary did not contact the companies that presented indicative offers for the operation application (Commercial společnost s r. o. or AGROING BRNO s.r.o.) or companies that had already delivered the same type of product to the beneficiary in the past (SIAGRA s.r.o.)
- Based on an analysis of the indicative offers, the price offered by the company TIS – CR s.r.o. was substantially higher than the indicative offers. For operation CZ.01.3.10/0.0/0.0/16_061/0011988 the indicative offer submitted by the company Commercial společnost s r. o. amounted to 4 012 000 CZK for the technology part and the price presented by company TIS – CR s.r.o. amounted to 5 360 000 CZK, i.e. 34% higher; and
- The role of the representative of Cerea, a.s. currently an employee from another AGROFERT group company, Farmtec, a.s., is unclear and non-transparent.

Therefore, Commission auditors consider that a conflict of interests between the beneficiary and the company TIS – CR s.r.o. was also present during the second tender, that the conflict was inadequately mitigated by the beneficiary and the company TIS – CR s.r.o. won the contract.

**Action to be taken / recommendation**

**Recommendation**

The MA EIC should apply a financial correction of 100% for the abovementioned contracts in line with point 21 of the Guidelines for determining financial corrections to be made to expenditure financed by the Union under shared management, for non-compliance with the rules on public procurement, related to established cases of conflict of interests and cancel the related public contribution.

Importance: Very important

Body responsible: OP EIC managing authority
Deadline for implementation: 2 months

Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[260] The indicative offers submitted in relation to the application for aid are orientational and reflect the current state of affairs on the market at the given point in space and time. Similarly, their content does not need to be detailed, as the project is not assessed down to the minutest details, but merely using the basic constant parameters. A detailed and more or less precise budget containing detailed requirements emerges prior to implementation. Given that unforeseen circumstances frequently need to be dealt with at the building site, the budget is sometimes adjusted during construction. Similarly, the technologies procured are frequently upgraded and newer variants are used, as it may be that several years elapse between the project’s inception and its implementation. In recent years, workforce in the construction sector in the Czech Republic has been in short supply. Qualified workers are particularly hard to come by, resulting in a substantial increase in prices. It can happen that in the course of a single year the price will increase by several percent in comparison to the indicative price offers originally submitted. Similarly, it may happen that, as the years go by and the project is being implemented, the technology in question may be subject to innovations and that when procuring the machinery the applicant will opt for the most modern technology, resulting in a budget increase. Nevertheless, following the process of grant application evaluation, the budgets (items of eligible expenditure) are capped, which means that even if the applicant or grant beneficiary opts for a more expensive solution provided by, inter alia, innovative technology, or if the selection procedure is awarded for a price that is higher than the original price in the budget for the grant application submitted, the costs exceeding the cap of eligible expenditure must be borne by the grant recipient from their own budget. From the point of view of the project, such expenditure is ineligible.

[261] In the case of project CZ.01.1.00/0.0/0.0/16 061/0011988, the MA OP EIC expressed its consent by email, as it was necessary to resolve the issue promptly, so as to not to jeopardise the implementation of the project. As the first procurement procedure was cancelled, there was little time to implement a second procurement procedure. This is why the aforementioned consent of 20 September 2018 was given. In our view, the efforts of the MA OP EIC aimed at ensuring the transparency of the second procurement procedure were sufficient. The MA OP EIC is nevertheless unable to force economic entities to participate in procurement procedures. Project implementation should not be thwarted if the invited companies decide not to take part in the selection procedure for whatever reason, be it due to the extra administrative burden related to work performed on the basis of a public tender, insufficient processing capacity available, inconvenient timeframe for implementation etc.). In line with MA OP EIC rules, prior to signing their contract with the supplier, the grant recipient should notify MA OP EIC of any potential conflict of interest if they are aware of it. In the case under examination, when performing a check of the selection procedure, the MA OP EIC determined the existence of a potential conflict of interest, which the grant recipient had failed to notify as per the Rules for selecting suppliers, and concluded the contract. In this regard, the MA OP EIC proposed a reduction for failing to report a potential conflict of interest prior to the conclusion of the contract. However, the recipient continued to act in line with the further MA OP EIC recommendations and cancelled the first tender procedure, re-evaluating and reviewing the subject of the service, the technical specification of the service required and also verified the assessment criteria with the aim to detect and, if necessary, of course also to
remove the potentially discriminative elements of the tender procedure published. These MA OP EIC recommendations were aimed at removing all other causes that could result in only one bid submitted. With regard to preventing conflict of interest, we would emphasise that on its own, the mere existence of a personal link does not necessarily amount to fraud, corruption or other unfair practices.\textsuperscript{58} If the efforts aimed at ensuring the transparency of the selection procedure were sufficient (fair specifications, selection and evaluation criteria, several potential suppliers invited, market price of the successful tender) and thus the potential conflict of interest has no impact on public procurement, then the existence of a personal link between the representatives of the contracting authority and the successful bidder should not be an obstacle to the implementation of the project. \textit{Per analogiam}, this also applies to projects CZ.01.3.10/0.0/0.0/16_061/0011143 and CZ.01.3.10/0.0/0.0/16_061/0011152.

[262] The MA OP EIC takes the view that in the case of projects No CZ.01.3.10/0.0/0.0/16_061/0011139 and CZ.01.3.10/0.0/0.0/16_061/0011875 there were errors on the part of the grant recipient. The Rules for selecting suppliers oblige the grant recipient to report any potential conflict of interest on the part of the grant provider immediately. As you can see from the attached ARACHNE 1-4 print screen, the IB API project manager was unable to detect the potential conflict of interest even using ARACHNE. Since the MA OP EIC manages thousands of grant applications and subsequently issues thousands of grant award decisions, the individual projects under a single programme/single call are administered by various PM API, which manage the relevant projects under varying time horizons. One of the elements of project verification is whether the same applicants do not continue to submit identical or similar projects. However, due to the considerable number of the administered projects and the RoPDs issued, it is impossible to verify in detail whether in the dozens of other potential selection procedures there is no conflict of interest between the supplier and the contracting authority with regard to the same grant applicant. Potential conflict of interest is not detectable on the basis of a query in the Commercial Register, Trade Licence Register and ARACHNE. As has been stated above, the grant recipients are currently obliged by the Rules for selecting suppliers to immediately inform the MA OP EIC of a potential conflict of interest prior to signing the contract.

[263] One of the reasons why the auditors disagree with the approach taken by the MA is that the contracting authority failed to invite to submit offers also those companies that had submitted indicative offers. In that context we would point out that the grant recipient is not obliged to get in touch with these potential suppliers, or to invite them to participate in the procurement procedure. We believe that such an approach could also be considered discriminatory, since the companies in question could potentially enjoy an advantage as compared with other participants, as they would know in advance the technical requirements of the subject of the service required, and could obtain an overview of the price offered etc. (see response to finding 11\textsuperscript{59}). In that connection we believe that the function of \underline{\textcolor{red}{is currently irrelevant}}, also because Farmtec, a.s. was not the winning participant in any of the

\textsuperscript{58} See point 46 of our response.

\textsuperscript{59} Furthermore, the MA OP EIC concludes that it does not follow from the guidance documents governing the selection of suppliers for tenders under co-financed projects that the contracting authority is obliged to invite those suppliers to submit offers whose indicative offers had been used when drawing up the project. Under the Public Procurement Act, the contracting authority has no such obligation, either. In no other type of procurement procedure (such as the simplified ‘under the threshold’ procedure) is the contracting authority obliged to invite the suppliers with whom the preliminary market survey was performed to submit an offer. On the contrary, such an approach would likely be considered as being against the law and discriminatory with regard to suppliers that the contracting authority has not yet contacted.
This finding concludes the existence of a potential conflict of interest between the contracting authority and the supplier (the winning bidder), requesting a financial correction of 100% with regard to the relevant contracts in line with point 21 of the Guideline for financial correction in the area of public procurement, to be implemented with regard to expenditure funded by the EU under shared management in the event of non-compliance with the rules on public procurement. However, the finding makes no reference to a genuine manifestation of this conflict of interest affecting the outcome of the tender procedure, which is at variance with Commission Decision (2019) 3452 of 14 May 2019. The finding only concludes the existence of a potential conflict of interest without referring to any impact on this contract. On this basis it is impossible to apply the 100% penalty that the Commission calls for.

Meanwhile, also CJEU case law concerning conflict of interest in the area of public procurement makes it clear that conflict of interest may not be purely hypothetical (see point 46 of this reaction).

With regard to projects CZ.01.3.10/0.0/0.0/16_061/0011139 and CZ.01.3.10/0.0/0.0/16_061/0011875 it is possible to conclude that the Rules for selecting suppliers were violated on account of the failure on the part of the grant recipient to notify the grant provider of the potential conflict of interest; in that context, the MA OP EIC will verify the projects concerned with regard to the potential conflict of interest detected. However, on the basis of these arguments (as well as case-law), it is in our view impossible, without a clear impact having been demonstrated, to apply a 100% penalty without further verification. In line with the above, we therefore currently reject the request to implement the recommendation (i.e. the 100% correction), since no genuine impact on the outcome of the procurement procedure has been demonstrated.

The MA OP EIC does not agree with the finding concerning project CZ.01.3.10/0.0/0.0/16_061/0011988, CZ.01.3.10/0.0/0.0/16_061/0011143 a CZ.01.3.10/0.0/0.0/16_061/0011152 and requests its withdrawal.

Conclusion of the Commission services:

The finding is maintained.

REGIO auditors understand that the Czech authorities confirmed the risk of potential conflict of interest in case of five operations implemented by beneficiary Cerea a.s. (261 & 266) for the family reasons. This risk has neither been excluded nor mitigated even though the beneficiary launched the second round of the tender procedure for 3 out of five operations.

It should be noted that it is the role of the Commission to verify that Member states finance through the ESI Funds only actions conducted in complete conformity with the EU law including the basic principles of transparency, equal treatment and non-discrimination. The avoidance of conflict of interest is part of the requirements stemming from the Financial Regulation 2018. An infringement of the EU law constitutes an irregularity within the meaning of the provision of Article 36(3)(c) and Article (61) of that Regulation only if it has or would have the effect of prejudicing the general budget of the Union by charging an unjustified item of expenditure to that budget. Therefore, such an infringement must be considered to be an irregularity in so far as it is capable, as such, to have a budgetary impact. By contrast, there is no requirement that the existence of a specific financial impact be shown.
Consequently, it should be considered that a failure to comply with the national ‘Rules for selection of suppliers’ in conjunction with Financial Regulation requirements on conflict of interest constitutes an irregularity within the meaning of the Article 2(36) of the Regulation No 1303/2013 in so far as the possibility cannot be excluded that such failure has an impact on the budget of the ESI Funds.

REGIO auditors would like to underline that the potential conflict of interest for family reasons was established by the IB API for 3 operations no. CZ.01.3.10/0.0/0.0/16_061/0011143, CZ.01.3.10/0.0/0.0/16_061/0011152 and CZ.01.3.10/0.0/0.0/16_061/0011988 between Cerea, a.s. (acting as contracting authority) and the winning company TIS – CR s.r.o. Therefore, it was a real and not hypothetical situation as the contracts signed between the beneficiary and the winning company were cancelled by the IB and the MA at a later stage due to the identified conflict of interest. Knowing that such a risk existed and was confirmed, the MA should review all other similar contracts and procedures and should cancel them for the same reason of the identified risk of conflict of interest according to the national ‘Rules for selection of suppliers’. Moreover, each and every next time the company for which the conflict of interest was identified earlier, should be refrained from participating in the call for bids as the conflict of interest as such was not mitigated. The contracting authority (Cerea a.s.) allowed the bidder (TIS-CR a.s.) to demonstrate that there is no risk of conflict of interest. The former failed to do so during the first tender procedure as it did not disclose the information about the family links between the management of both companies. There should not be any subsequent chance to repair such a situation if the conflict of interest for the family reasons was confirmed. It is obvious that it might impact on impartiality and objectivity of the contracting authority and jeopardise each next tender procedure if the risk is not fully mitigated. The Commission services cannot agree with the Czech authorities’ conclusion that the efforts made by the beneficiary (contracting authority) aiming at transparency of the selection procedure were sufficient. As presented in the draft audit report not all possible bidders were contacted for the purpose of receiving the offers during the second tender procedure (Commercial společnost s r. o. or AGROING BRNO s.r.o. or SIAGRA s.r.o.) and as such a potential conflict of interest was present during the second tender procedure as well. The family links between the bidder and the contracting authority were not removed and could still have an impact on selection of the successful bidder during the second tender procedure jeopardising its impartiality and objectivity.

Therefore, the risk of potential conflict of interest was still in place during the second tender procedure for contract CZ.01.3.10/0.0/0.0/16_061/0011988 as it was also for contracts CZ.01.3.10/0.0/0.0/16_061/0011143, CZ.01.3.10/0.0/0.0/16_061/0011152 and it was present for two similar contracts that were not subject of cancellation CZ.01.3.10/0.0/0.0/16_061/0011139 and CZ.01.3.10/0.0/0.0/16_061/0011875.

The Commission services do not understand nor accept the arguments of the managing authority that there was limited time to implement a second procurement procedure [261] and that to do so may have ‘jeopardised implementation’. These are not valid reasons for not complying with the relevant procurement rules. In addition, in the case of the five abovementioned operations, the managing authority, in light of the fact that the applicant had not disclosed a conflict of interest situation relating to the original procurement which, as a result, had to be cancelled, could have insisted on widening competition by insisting that all those companies that had previously submitted indicative offers were invited to participate by the beneficiary. This was not done.

The Commission services reiterate their conclusions that the MA EIC should apply a financial correction of 100% for the abovementioned contracts in line with point 21 of the Commission ‘Guidelines for determining financial corrections to be made to expenditure financed by the
Union under shared management, for non-compliance with the rules on public procurement, related to established cases of conflict of interests and cancel the related public contribution.

The recommendation remains open.

Importance: Very important

Body responsible: OP EIC managing authority

Deadline for implementation: 2 months
**Finding 13**

Key requirement: KR 4 - Appropriate management verifications

**Non-transparent publication of tender proceedings:**

It is acknowledged that the majority of the procurement contracts in the OP EIC is not subject to the EU / national public procurement law (private companies with public funding below 50%). However, the basic principles of transparency, equal treatment and non-discrimination are transposed into the detailed binding national 'Rules for selection of suppliers'.

In accordance with the 'Rules for the selection of suppliers' valid from 2 May 2017 the tender procedure shall be initiated by the publication of a tender notice on the **contracting authority’s profile**. A contracting authority’s profile is an individual website profile (internet address), where each beneficiary publishes his tenders. The internet address of the contracting authority is required to be published in the Public Procurement Bulletin.

The search in the Public Procurement Bulletin for tender procedures that do not fall under the Czech Act no 134/2016 Coll. on the award of public contracts, is based only on the name of the contracting authority or its company registry code. A search using other criteria such as CPV code or the subject of the tender procedure, is not possible.

It means that the tender notices related to tender procedures, which do not fall under Act no 134/2016 Coll., on the award of public contracts, are **not** published centrally in the Public Procurement Bulletin and/or website of the OP EIC. In reality, it means that potential suppliers must monitor on a regular basis individual profiles of each contracting authority. This leads to a restriction of competition for tenders published under the OP EIC, non-transparent procedures and to the increased number of single bids as shown in the table below:

<table>
<thead>
<tr>
<th>Operation No</th>
<th>Tender</th>
<th>Estimated value (CZK)</th>
<th>Number of submitted bids</th>
<th>Winning bidder</th>
</tr>
</thead>
<tbody>
<tr>
<td>CZ.01.3.10/0.0/0.0/16_06/0011139</td>
<td>Cerea - Sušárna zmin Havlíčkův Brod</td>
<td>9.000.000</td>
<td>1</td>
<td>TIS – CR s.r.o.</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/16_06/0011143</td>
<td>Cerea - Sušárna zmin Chotěboř</td>
<td>10.000.000</td>
<td>1</td>
<td>TIS – CR s.r.o.</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/16_06/0111152</td>
<td>Cerea - Sušárna zmin Říkov</td>
<td>10.000.000</td>
<td>1</td>
<td>TIS – CR s.r.o.</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/16_06/0011875</td>
<td>Cerea - Sušárna zmin Dobřenice</td>
<td>10.000.000</td>
<td>1</td>
<td>TIS – CR s.r.o.</td>
</tr>
<tr>
<td>CZ.01.3.10/0.0/0.0/16_06/0011988</td>
<td>Cerea - Sušárna zmin Jičín</td>
<td>7.000.000</td>
<td>1</td>
<td>TIS – CR s.r.o.</td>
</tr>
</tbody>
</table>

In the view of Commission’s auditors this is not in line with the principles of transparency, non-discrimination and equal treatment of suppliers.
Action to be taken / recommendation

Recommendation

In order to increase competition in the tenders in the OP EIC and to prevent single bidding, the MA EIC is requested to ensure that all tender notices are published on the MA EIC website or other suitable website accessible to all potential bidders. This should ensure that all potential bidders can easily search for and participate in these tenders. In addition, there should be a requirement to obtain a minimum number (e.g. three) of offers from contractors that are unrelated to the procuring company.

Importance: Very important

Body responsible: OP EIC managing authority, national coordination body

Deadline for implementation: 2 months

Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[267] The MA of the Operational Programme 'Entrepreneurship and Innovation for Competitiveness' (MA OPEIC) acted in accordance with the rules laid down and with the binding Methodological Guidelines for Public Procurement (Czech abbreviation MPZ) in the 2014-2020 programming period, version 4, issued on 20 March 2017 by the Czech Ministry of Regional Development, in its capacity as national coordination authority, and which entered into force on 1 May 2017. According to this version of the MPZ, the MA OPEIC – which until then, under the Rules for the Selection of Suppliers, had requested publication of the notice in the Public Procurement Bulletin – operated in accordance with the MPZ and with the Public Procurement Act. **Pursuant to page 9 of the MPZ, the contracting authority’s profile is an electronic tool defined by Article 214 of the Public Procurement Act.** Under the Rules for the Selection of Suppliers the MA OPEIC acts in accordance with the binding MPZ, which states the following in Chapter 7.1.1. et seq.:

> The contracting authority may award the contract either: a) in an open call or b) in the case of small contracts, in a closed call.

> A beneficiary that is not a contracting authority pursuant to Article 4(1) to (3) of the Public Procurement Act, and where the aid awarded for such a contract is no higher than 50%, may launch a closed procedure for a works contract whose projected value does not exceed CZK 20 million, excluding VAT.

> 7.1.2 In an open call the contracting authority shall inform an unlimited number of suppliers of its intention to award the contracts in the selection procedure by means of a notice of open competition; a notice of an open call is an invitation to tender for suppliers. **The contracting authority shall publish the notice of the invitation to tender throughout the duration of the period for submitting tenders:** a) on the contracting authority’s profile, b) in the national electronic tool or c) on the Programme’s website.

> After publication, the contracting authority may send out a call to certain suppliers; in which case it must be sent to at least three.

> 7.1.3 In a closed call the contracting authority shall invite at least three suppliers in writing to submit tenders. The contracting authority shall invite only suppliers
who it knows are capable of providing the services in question. The contracting authority shall not repeatedly invite the same pool of suppliers, except where justified by the subject of the contract, other special circumstances or the cancellation of a previous tender procedure.

7.1.4 Where the subject of the procurement allows, the contracting authority may award the contract on an electronic marketplace. In which case, the contracting authority shall proceed in accordance with the rules governing the electronic marketplace; if so, these Guidelines shall not apply. The principles laid down in paragraph 6.1.1 of the Guidelines shall, however, apply.

[268] As regards the requirement to set a minimum number of tenders received, this recommendation strikes us as highly unrealistic (cf. the MA OPEIC’s opinion on findings 11 and 12). The whole selection process is highly complex and sets additional demands on potential bidders and in particular the successful bidder, which may be very restrictive for suppliers. We feel that one of the main reasons why there are so few bidders (meaning that a very small number of tenders are submitted) is the burdensome nature of the whole selection process. We refer, of course, to the time involved: if errors have been detected the selection process needs to be extended, pushed back or possibly cancelled altogether and republished, in which case potential beneficiaries may be unable to meet deadlines or may face uncertainty as to when the selection procedure will be concluded and, for example, how long they will have to hold on to their working capacity. This requirement would not, of course, lead to the procurement of ‘unique technologies’, which in certain cases only one or two suppliers are capable of delivering.

[269] We would also point out that, in the case of listed projects where only one tender was submitted, there is no evidence that overcharging took place or that the price set was not the market price, etc. The MA OPEIC argues that if only one tender is received it cannot be concluded that there is something wrong with the tender procedure, or that an inappropriate market price for the subject of the service was set.

The response from the procurement law department of the Ministry of Regional Development, which is responsible for Act No 137/2006 on public procurement in the Czech Republic.

[270] In relation to this finding, the EC’s recommendation, classified as ‘very important’, is that, to increase competition and to prevent single bidding, the MA OPEIC should ‘ensure that all tender notices are published on the MA OPEIC website or any other suitable website accessible to all potential bidders. This should ensure that all potential bidders can easily search for and participate in these tenders. In addition, there should be a requirement to obtain a minimum number (e.g. three) of offers from contractors that are unrelated to the procuring company.’

[271] With regard to the complaint that the publication on the contracting authority’s profile is inadequate, we hereby state the following:

[272] The Commission’s argument is based on the idea that the notice of the launch of the competition must be published on the contracting authority’s profile, which is a separate website (internet address), where the beneficiary publishes its tenders that do not fall under the Public Procurement Act, which means according to the Commission that the contracts are not published centrally.

[273] We add that, pursuant to Article 28(1)(j) of the Public Procurement Act, the contracting authority’s profile is an electronic tool, which must comply with the strict requirements laid down in said law and its implementing legislation; compliance is monitored when the
electronic tool is certified (cf. Regulation on electronic instruments No 260/2016). This means, for example, that the contracting authority’s profile must offer all suppliers (and any other entities) unrestricted remote access. As with any electronic tool, the contracting authority’s profile shall be entirely free for the supplier to use; it shall be publicly available and compatible with commonly used IT (cf. Article 213 of the Public Procurement Act). It is therefore beyond doubt that suppliers have unrestricted access to the notice of publication on the contracting authority’s profile.

[274] With regard to the contention that notices published on the contracting authority’s profile are not published centrally, we would stress that this argument is not in the least supported in the procurement directives, which lay down a requirement whereby, for above-threshold public procurement contracts, the tender notice must be published in TED (Tenders Electronic Daily). The Commission’s argument is also not backed up by the Czech Public Procurement Act, which has a requirement for notices to be published in the Public Procurement Bulletin only for below-threshold public procurement contracts. The requirement whereby the notice of contracts for aid recipients not covered by the implementation of the procurement directives or the Public Procurement Act must be published centrally is therefore unfounded.

[275] Under the rules for selecting suppliers the MA OPEIC lays down an obligation to publish the public procurement notice, along with a detailed description of the contract, on the contracting authority’s profile. This constitutes sufficient guarantee that potential tenderers have access to the relevant information.

[276] We would add that, pursuant to Article 28(1)(j) of the Public Procurement Act, the contracting authority’s profiles are operated normally by a (suitably narrow) group of operators of contracting authority profiles whose websites can be searched for all contracts awarded by registered contracting entities.

[277] Regarding the recommendation on setting the minimum number of tenders submitted we would state the following:

[278] We would reiterate and emphasise that such a requirement has absolutely no basis in either European or Czech law. Since a similar rule does not apply to public procurement falling within the scope of the Directive and the Czech Public Procurement Act, it cannot apply to contracts to which neither Directives nor the Public Procurement are applicable. We would also stress that the contracting authorities and the MA OPEIC have virtually no influence on the number of economic operators interested in applying for specific contracts.

[279] In relation to this finding the MA OPEIC notes that contracts are published in accordance with Czech law and with sufficient transparency. The recommendation on the publication of contracts on the MA OPEIC website is currently impossible to put into practice due to the time it would take to incorporate such modules into the website, and to ensure that the site is operating, its administration is working, and is adapted to a high number of visitors, etc. At the same time, the MA OPEIC would have to take on a great deal of responsibility in the event of malfunction or publication delays. For these and other reasons, the MA OPEIC could face legal action. As for any recommendation to publish on another single website, the MA OPEIC considers that such an obligation could lead to a further increase in administration for the MA in terms of publishing the tender, and for the applicant and the grant beneficiary, since they would have to proceed in accordance with IMP, under which tender procedures on the contracting authority’s profile must be published in the Public Procurement Bulletin and on specific websites. At the same time, there would be an increase in the administration and monitoring of the tender procedure, as another website would have to be monitored in terms of what has
been published and in what form, and if the publication took place on the same day, with the same content, etc. Accordingly, the MA OPEIC also rejects the establishment of a minimum number of tenders under a tender procedure.

In light of the above, we do not accept finding No 13 and request that it be removed

Conclusion of the Commission services:

The recommendation is partly maintained and further clarified.

The Commission services note the explanations provided by the Czech authorities in their reply [267 - 279] that, for contracts not falling under the Czech Act No 134/2016 Coll, under national guidelines, the tender notice may be published in any one of the following three ways:

1. in the National Electronic Tool (NEN) system or
2. on the MA website, or
3. on the contracting authority’s profile.

In this regard, the Commission services note potential tenderers can easily search the NEN or the MA website (where this is used for particular OPs) for tenders that they are potentially interested in.

However, in relation to point 276 the Commission auditors disagree that it is transparent and easy to search. For tender procedures that are published only on the contracting authority’s (beneficiary’s) profile it is very difficult for potential tenderers to search these profiles to identify contracts that they may be interested in.

For example, if an economic operator wants to identify all current tenders under the OP EIC where these are only published on the contracting authority’s profile, it needs to:

1. search individually in the Public Procurement Bulletin for an individual contracting authority’s profile for each beneficiary by entering the name or ID number of the beneficiary. This requires to know that the specific beneficiary were granted a project under the programme and that such beneficiary intends to publish tenders;

2. then search, one-by-one, in each profile all the published tenders in order to identify those that the potential tenderer may be interested in.

This is an extremely cumbersome process and does not facilitate identification of tenders by potentially interested contractors. This works against the intended aim of achieving an adequate level of competition and thereby value for money.

The Czech authorities claim [point 276] that economic operators can monitor the webpages of the commercial providers where the contracting authority’s (beneficiary’s) profile are hosted, as these are limited in number. While this may be a possibility, the Commission auditors consider it to be an unnecessarily time consuming requirement for potential tenderers.

In this regard and to simplify the process, some managing authorities publish all tender notices on their websites (e.g. OP Employment[65]). These websites are easily searchable by potential tenderers. In this regard the Commission services take note of the explanation provided by the Czech authorities in point 279, that the publication of contracts on the MA EIC website is currently impossible due to the time needed to incorporate such modules into

[65] https://www.esfcr.cz/zadavaci-rizeni-opz
the website, and to ensure that the website is operational, its administration is working, and is adapted to a high number of visitors.

The Commission services also note that one of the possibilities to publish a public tender notice is by using the National Electronic Tool (NEN). This tool was co-financed from the Integrated Regional OP and is used for administration, public procurement and concessions covering all categories of public procurements and contracting authorities. Potential tenderers can also readily search for and identify contracts that they may be interested in using this tool.

Therefore, the recommendation to ensure that all tender notices are published on the MA EIC website or other suitable websites, easily searchable by potential tenderers remains open.

In relation to the draft audit report recommendation to obtain a minimum of 3 offers the Member State’s explanation that it is not possible to guarantee that a minimum number of tenderers will submit offers is acknowledged, and this part of the finding is therefore dropped.

Importance: Very important

Body responsible: OP EIC managing authority, national coordination body

Deadline for implementation: 2 months
Finding 14

Key requirement: KR 4 - Appropriate management verifications

Inadequate management verifications of procurements as regards conflict of interests

The Commission services noted that finding no 5(b) of the audit authority’s system audit no OPPIK/2018/S/001 deals with the inadequate management verifications of public procurements. As explained by the audit authority in the audit report, the MA EIC does not verify the connections between beneficiaries (contracting authority), bidders/suppliers and the bodies, who drafted tender documentation for all procurements.

The Commission services took note that the MA EIC stated in its reply that:

‘(…) Moreover, the methodological guideline for the exercise of controls, as well as any other methodological guideline, does not provide an entirely clear list of what the conflict of interest is and what is not. Even if, for example, family ties were identified through ARACHNE or any other similar tool, no methodological guideline sets on how the managing authority should further proceed and the actual family link, with regard to the definition of conflict of interest in order to establish the existence of a conflict of interest, is not enough. (…)’

‘(…) We require an audit authority to help us to initiate a change to the methodological guideline in question. (…)’

As per Article 125 of the CPR, the MA EIC is responsible for managing the operational programme. Moreover, under the same article, the MA EIC shall put in place effective and proportionate anti-fraud measures for the operational programme.

Therefore, it is the responsibility of the MA EIC to take appropriate actions as regards the prevention and detection of conflict of interests for procurements linked with the OP EIC and to take appropriate measures to correct and recover ineligible expenditure affected by the conflict of interest in case it is detected. The finding no 12 shows that the MA EIC was not able to make financial corrections for such cases of conflict of interest.

The programme authorities are reminded that they are required to put in place an adequate management and control system in accordance with Article 122 of the CPR. This obligation includes, in accordance with Article 63(1) and (4) read in conjunction with Article 36(3)(c) of the new Financial Regulation, the requirement for those systems to be capable of avoiding conflict of interest. This obligation covers the need to have in place controls systems that ensure their effective and efficient application.

Action to be taken / recommendation

Recommendation 14.01

The MA EIC is requested to take appropriate actions related to the recommendation of the audit authority in the national system audit report no OPPIK/2018/S/001. The Commission services note that the action plan for this finding is still ongoing. Nevertheless, the Commission services emphasise the importance of it being implemented by 30 June 2019 and that the MA EIC verify conflict of interest using ARACHNE or another similar tool, at least on a sample basis.

Recommendation 14.02

The AA is recommended to carefully follow-up its recommendation and to verify that improvements in the identification of conflict of interest are in place for OP EIC.
Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[280] As part of the checklists for tender procedures, the MA OPEC has included question 14 (see table below).

<table>
<thead>
<tr>
<th></th>
<th>Can it be concluded, on the basis of the facts submitted, that there were no conflicts of interest?</th>
<th>The condition of impartiality shall be deemed not to have been met by those who have taken part in the processing of the tender, have a personal, employment or other similar ties with the tenderer or for some other reason have a vested interest in the award of the public procurement contract to a particular tenderer.</th>
</tr>
</thead>
</table>

[281] The MA OPEC checks for conflicts of interest in tender procedures, in particular when examining tenders, which are, inter alia, documented in accordance with the rules governing the selection of suppliers, and checks declarations of honour. Other available registers, such as the commercial register and the trade licensing register, are also used to monitor conflicts of interest. As regards ARACHNE, the links in this tool are neither up to date nor complete, and are therefore currently unusable (cf. comments on findings 12 and 13). The Czech Republic does not accept the recommendation because the MA has already taken the steps contained therein.

In light of the above, we do not accept finding No 14 and request that it be removed.

Conclusion of the Commission services:

The finding is maintained.

The Commission services take note of the Member State’s reply [280-282] but do not accept the arguments presented by the Czech authorities.

The finding relates to the audit authority’s system audit carried out in 2018. In their reply, the Czech authorities refer to question No 14 (‘Can it be concluded, on the basis of the facts submitted, that there were no conflicts of interest?’). However, as question No 14 was already included in the MA EIC’s checklist at the time of the audit authority’s audit (i.e. in 2018 -
finding no 5(b) of the system audit report) this question was not considered as sufficient by
the audit authority to address the identified issues.

As the Member State’s reply does not address the identified issues, the recommendations
remain open.

Recommendation 14.01

The MA EiC is requested to take appropriate actions related to the recommendation of the
audit authority in the national system audit report no OPPIK/2018/S/001. The Commission
services note that the action plan for this finding is still ongoing.

Recommendation 14.02

The audit authority is recommended to follow-up its recommendation and to verify that
improvements in the identification of conflict of interest are in place for OP EIC. The audit
authority’s follow up system audit should be sent to the Commission services as soon as it has
been finalised.

Importance: Very important
Body responsible: OP EIC managing authority
Deadline for implementation: 2 months
5.2.3.3. Findings on the operations

Finding 15

Operation no CZ.01.1.02/0.0/0.0/15_014/0000516 (beneficiary Pekárna Zelená louka, a.s.)
—ineligible operation

The operation CZ.01.1.02/0.0/0.0/15_014/0000516 (Innovation line for the production of toast bread), under objective 1.1, aimed at increasing the technical value and efficiency of technology for the production of toast bread and the properties of new products (removal of preservatives, reduction of salt, extension of shelf life, improvement of taste). The operation outcome presented in the grant application is the process innovation, i.e. acquisition of a technology line with significant innovative components (ingredients storage and intakes, vacuum kneading, cleanroom, an innovative production control system) enabling new products, i.e. three innovative products to be produced (i.e. three types of toast bread containing wheat yeast). The beneficiary of the operation, Pekárna Zelená louka, a.s. is a subsidiary of Agrofert, a.s., a parent company of the AGROFERT group.

In accordance with the Call for operations no 01_15_014 Innovations – can only be supported operations:

- with direct links to Research & Development activities, i.e. they use the results of the own Research & Development, the Research & Development results created during the cooperation or the transfers of technology; and
- for which the Research & Development activities must be completed and demonstrably documented.

From such Research & Development activities the prototype or the sample should have been presented by the applicant/the beneficiary in the grant application.

Part A (Exclusion selection criteria) of the selection criteria for the Call for operations no 01_15_014 Innovations stipulated in point 3 ‘Link of the operation to Research & Development activities’ that:

- 'the development has been finalised;'
- the operation uses the results of own Research & Development, the Research & Development results created during the cooperation or the transfers of technology;
- in case of own Research & Development or the Research & Development results created during the cooperation the applicant must prove the existence of the functional prototype or the sample;
- in the case of the transfer of technology the applicant must prove the existence of the functional prototype or the sample and this transfer must be contractually supported.'

However, the real results of the own Research & Development, the Research & Development results created during the cooperation, or the transfers of technology were not presented by the applicant in its grant application.

To prove the Research & Development results created during the cooperation, the applicant submitted:

- a Framework contract for partnership and cooperation in research related to bakery products (signed in February 2015);
• a Treaty on intellectual property rights (signed in March 2015) with The University of Chemistry and Technology Prague (Vysoká škola chemicko-technologická v Praze – ‘VSCHT’); and

• Future planned activities by the university in relation to the toast breads of 24 April 2015 – in the form of a declaration signed only by the university.

None of the documents prove that the cooperation between the applicant and the university took place at the time of the submission of the grant application and that such cooperation was completed. No prototypes / samples from such cooperation were presented by the applicant as requested in the call rules.

Furthermore, the applicant described in the application and presented as a prototype a clean room technology, as the result of the own Research & Development. The applicant presented a pilot line in the bakery in Olomouc as the prototype. In fact, there is no evidence to prove the actual Research & Development, only the selection procedure for the purchase of chilling technology for bread and veils – the cooling spiral for bread and veils and the test minutes from the functioning of the installed technology. The cooling technology is available on the market and is being used by modern bakeries all over the world. Therefore, in the view of the Commission services, the supply of the ‘pilot line’ was a standard purchase of a new technology without any links to the own Research & Development activities. This question was also raised by the selection committee, as shown in point 2 of this finding.

Moreover, the Commission services identified the following observations, which undermine the transparency, equal treatment and the fairness of the selection procedure of the operation in question:

1. **Insufficient audit trail and non-compliance with internal procedures in relation to internal evaluators and external experts**

   • The internal project evaluators were not selected randomly even though this was a requirement the OP manual. Instead, they were assigned in a discretionary manner from a limited number of employees from the unit responsible for the evaluation of the respective call. There was no audit trail to explain how assignments were attributed.

   • One internal evaluator was replaced and there is no audit trail for the reasons behind this change.

   • The experience and education of both internal evaluators do not correspond to the subject matter of the operation. Based on interviews with the MA EIC’s employees, both evaluators based their opinions on the external evaluations. This is in line with the OP methodology. In case the required expertise goes beyond the professional capacity of an internal evaluator, the evaluator may request an external expert’s opinion as a support for his/her evaluation. However, there is no record that the internal evaluators requested such expertise.

   • During the audit mission on the spot, it was not clear how many external experts were involved in the operation evaluation. The numbers were different depending upon the person interviewed. It was only based on additional information received by email after the mission on the spot, that the number of external evaluators was clarified by the MA EIC.

   • One of the external evaluator, external evaluator 1 was replaced by other external evaluator, external expert 2, for not being reliable. From the email correspondence, the auditors identified that external expert 1 only requested a deadline extension until 24
June 2016 because he had not received indicative offers for the budget evaluation. This was not accepted by the MA EIC with comment that such prolongation is not possible. Taking into account that the external evaluator 2 issued his evaluation only on 2 August 2016, the reason for replacement of this expert is not justified.

2. Evaluation and scoring by the evaluators not properly performed and justified

In accordance with the OP Manual - annex D_01_M the evaluation should contain the explanation and number of points awarded. The OP Manual, part D3 stipulates that:

'Internal evaluators for each acceptable grant application that successfully passed a formal evaluation, complete in MS2014+ an assessment form 'the Assessment of the internal evaluator (D3_01_F_assessment of the internal evaluator), the evaluator for each criterion shall set out a clear and comprehensible justification for the outcome of his assessment."

[...]

An external evaluation will be a narrative and will include a reference scoring to be followed by the internal evaluator during the consolidation of the internal assessment. If the internal evaluator does not take over the scoring of an external evaluator or some of his arguments, it shall justify why and explicitly comment on the rejected external evaluator's arguments.'

However, in case of operation CZ.01.1.02/0.0/0.0/15_014/0000516 the evaluators do not sufficiently justify the number of points allocated but limit their comments to either repeating/re-phrasing the text contained in the operation application or simply repeating the selection criteria wording without giving any justification.

In the case of the evaluation of external evaluator 2 the explanations were not provided for part C of the selection criteria relating to 'Necessity and relevance of the project'. The internal evaluator no 2823, who issued his opinion based on the external evaluator 2's evaluation, only copied the selection criteria wording into his answer. The Selection Committee returned both evaluations of the internal evaluators (see point 3 below) requesting additional clarifications. However, no clarification was provided by the internal evaluator no 2823. However, this evaluation was not rejected by the Selection Committee. This approach of the evaluators, e.g. copying the selection criteria wording, is contrary to the OP Manual.

In some cases, the evaluators refer to a specific document, which does not however justify the number of points allocated. All evaluators gave a maximum number of 5 points for criterion B.2 'Cooperation with public research institutions or universities in the area of research and development activities in the last 5 years'. The requirement for such points allocation is the existence of a long-term contract for joint research. A framework contract between the applicant and the VSCHT for partnership and cooperation in research related to bakery products was submitted with the grant application as described above in the finding description. The external evaluator 3 in its evaluation for this criterion provided that: 'Cooperation with VSCHT is evidenced by contracts and documents dating from 2015, which cannot be defined as 'long-term'.' Furthermore, in the evaluation for part C the same evaluator explained that: 'The cooperation with research organisations is at an average level and is more in declaratory line than in real research.' However, regardless of what the external evaluator 3 has said in his comment, he awarded the maximum number of points for this criterion.
In the case of Criterion C3 ‘the type of novelty of the resulting product based on Valenta scale’ two evaluators considered that the product (i.e. the toast bread) reached level 5 of innovation on the Valenta scale⁶¹ and two evaluators considered it as level 6:

Level 6 innovation: New generation, involving a change in all decisive functions of an element of business unit subject to innovation while preserving the original concept of its solution.

Level 5 innovation: New variant, representing a change in one or several functions of an element of business unit subject to innovation.

The Commission services disagree that the product innovation described by the applicant reaches level 5 or 6 of innovation on the Valenta scale. The result of the product innovation described by the applicant does not lead to a new variant or new generation of the product, which would represent a change in one or more of its functions. It is merely a qualitative adaptation of a product already produced by the applicant and his competitors and as such corresponds only to level 4 innovation on the Valenta scale.

In this context, the Commission services also note that the applicant in the first version of the business plan, an attachment to the grant application, states that the product innovation reaches the fifth or the sixth level of innovation. Based on a message sent by the intermediate body through MS 2014+ (‘Interní depeše’) on 15 January 2016, the applicant was invited to change the level of innovation to level 6 with the comment that: ‘the operation can be supported when reaching level 6 of innovation’. In the new version of the business plan the applicant changed the level of innovation to level 6. Nevertheless, the wording used was not changed and corresponds to level 5. This would have had an impact on the project evaluation.

3. Insufficient audit trail from the meeting of the selection committee

On 26 October 2016, the selection committee returned the operation to the internal evaluators with the following questions:

- What is the exploitation of the results of research and development in the operation?
- How are the Research & Development results in relation to the functional prototype/sample documented?

One of the internal evaluators provided an explanation. However, the issue of the functional prototype was not included in the reply. The second evaluator no 2823 only replied that he insisted on his previous evaluation, which was very brief and did not provide the reply to the two questions.

On 21 December 2016, the selection committee approved the operation. There is no audit trail from the meeting, no explanation why the committee accepted the evaluation of internal evaluator no 2823, only the list of approved operations, including the operation in question.

4. Character of the resulting products not innovative

The Commission services noted that a German company Lieken AG has since 2013 also been a member of the AGROFERT group. The Commission services identified that this company produced a toast bread under the brand name Golden Toast, containing wheat yeast, without preservatives, already in 2013. Therefore, when the operation application was submitted to the MA EIC in 2015, the innovative product announced by the company Pekárna Zelená louka, a.s. should not have been considered as innovative, as this product was already produced by the AGROFERT group, namely by the company Lieken AG.

Under the OP EIC, a model innovation operation under the specific objective 1.1 should consist:

‘in introducing new products in the production and placing them on the market and in associated increases in the effectiveness of manufacturing processes and other process innovation (introducing new organisation of business processes, innovating new product development and marketing processes, product certification processes, deployment of new sales channels etc.)’.

In accordance with ECJ case law, an undertaking is defined as a single economic entity having a common source of control. Therefore, as long as the group acts as a single economic unit, it shall be considered as one undertaking. The main prerequisite of the OP, developing a new product, was clearly not the case for the operation in question as the AGROFERT group already produced this product. Therefore, in the opinion of the Commission services the operation should not be supported by the OP EIC.

Therefore, based on the above elements, the Commission auditors consider that the operation was not selected in line with the provisions of Article 125(3) of the CPR and is ineligible.

**Action to be taken / recommendation**

a) The managing authority is requested to correct the ineligible expenditure already declared for this operation and to cancel the public contribution to it.

b) The managing authority is requested to ensure that the evaluation process provides robust evidence to demonstrate full compliance of grant applications with the selection criteria. Operations for which insufficient evidence of compliance is provided in the application should be set aside and a request for further information sent to the applicant. If ultimately they are not in line with the selection criteria they should be rejected.

c) The managing authority is requested to confirm that the selection criteria were appropriately applied for all remaining operations linked to the AGROFERT group and to apply the necessary additional corrections if needed.

**Importance:** Critical

**Body responsible:** OP EIC managing authority

**Deadline for implementation:** 2 months

**Position of the Member State:**

*Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.*

[283] The auditors rightly point out that aid applications, projects submitted and implemented in the ‘INNOVATION - Innovative Project’ programme, must have direct links to R&D activities, i.e. they must use the results of their own R&D, the results created during cooperation or the transfer of technology, for which the R&D activities must be completed and demonstrably documented. R&D documentation is therefore a compulsory annex to aid applications. This key condition is reflected in the substantive assessment as binary criterion ‘No 3 Link of project to R&D activities. **The project must meet the following conditions:**

The development has been finalised. (YES - NO)
The project uses the results of its own R&D, R&D results created during cooperation or a technology transfer at the implementation stage; (YES - NO)

a) In the case of own R&D results or R&D results creating during cooperation, the applicant must prove the existence of a functional prototype or sample;

b) In the case of transfer of technology the applicant must prove the existence of a functional prototype or sample and this transfer must be contractually supported. (YES — NO, either (a) or (b))

[284] A further four comments are added in relation to the above criterion:

1. In the case of economically linked entities, R&D activities in a joint R&D centre shall be considered as own R&D provided that the applicant is able to demonstrate, for example in the form of internal guidelines or a contract, that they are entitled to benefit from the R&D results of that centre.

2. For the purposes of the programme, technology transfer means the transfer of technology (such as prototypes and technological components) or technological processes (such as technological solutions and production processes) including intellectual property (such as patents and licences) and know-how developed by a research institution or university for industrial application in another entity. In the case of other entities, technology transfer means only the transmission of solutions protected by industrial property (patents/inventions, industrial or utility designs), either through the direct purchase of an industrial property right or the purchase of a licence for its use.

3. Documentation demonstrating the R&D results, technology transfer and the existence of a functional prototype/sample is a mandatory annex to the feasibility study. Clear demonstration of the existence of a working prototype of the product/process (based on the main focus of the project) is required in the form, for example, of a report from trials and testing.

4. Information required for evaluation is given in the business plan.

[285] The project to which finding 15 refers is that of aid applicant Pekárna Zelená louka, a.s., (ref. CZ.01.1.02/0.0/0/15_014/0000516): ‘Innovation line for the production of toast bread PENAM a.s.’.

[286] The project’s activities are defined in the call as product and process innovation. The product innovation concerns the placing on the market of three new products specifically using wheat yeast without the use of preservatives and with reduced common-salt content. The process innovation concerns the modification of the final parts of “cleanroom” technology, which will increase the products’ shelf life.

[287] The research activities on product innovation before the aid application was submitted took place in four phases:

1. research into literature on salt and practical analyses of wheat flour with various salt additions (design, calculations and theoretical evaluation of a new recipe, laboratory verification of the properties of flour with different salt additions, trial baking and sensory evaluation);

2. quality testing of wheat flour for producing toast bread (laboratory testing of flour properties);

3. proposal for a simplified recipe and a procedure for technological measurement of the dough for making toast bread, with the potential for use in normal baking with a
normal amount of salt and with a reduced amount of salt (laboratory verification of the properties of the flour, trial baking and laboratory evaluation);

4. practical testing of reduced amount of salt (sensory assessment of the quality of the baking).

[288] These activities were mainly carried out in cooperation with the Food and Biochemical Technology Faculty of Prague University of Chemistry and Technology, which is supported by the Framework Contract for partnership and cooperation on research in the field of bakery products, the Copyright Treaty and the main objectives of shared development. The existence of ‘functional samples’ of the innovative products is then based on product specifications, containing the physical, chemical and sensory requirements, and the laboratory and sensory assessments.

[289] Research activities on process innovation prior to the submission of the aid application covered a proposed technical solution and research into various materials, different types of refrigeration, optimisation of times and heat catchment areas, the method of sterilisation of the environment in a cooling spiral, measurement of mass and heat, flow rates, temperature of products, etc. These activities were carried out by the parent company PENAM a.s., which stated — in the form of a declaration on honour as required by the ‘INNOVATION - Innovative Project’ programme and in accordance with the above-mentioned binary criterion — that the parent company’s R&D activities could be used by the applicant, i.e. the subsidiary company. The verification of the results of R&D activities was supported by extracts from repeated cooling testing at the bakery in Olomouc.

[290] This leads to a combination of product and process innovation and a combination of own R&D activities (process innovation, cf. as in point 1. addition of criterion No 3, as mentioned above) and cooperation R&D activities (product innovation).

In light of the above, we cannot accept the auditors’ conclusions on finding 15, which state that the actual results of own R&D, the results of cooperation R&D or technology transfer by the applicant were not submitted in the grant application. Nor can we accept the conclusion that none of the documents prove that the cooperation between the applicant and the University took place at the time of the submission of the aid application and that such cooperation was completed or that no prototypes/functional samples had been presented.

Finding 15.1 - Insufficient audit trail and non-compliance with internal procedures in relation to internal evaluators and external experts

[291] In this regard we would state that internal evaluators were selected randomly, based on available staff capacity. Due to major staff shortages, the projects had to be assigned on an ad hoc basis.

[292] We cannot accept the auditors’ conclusions that one internal evaluator was replaced and there was no audit trail for the reasons behind this change. A list of all the evaluators who took part in the substantive project assessment is in the MS2014+ system under the ‘DHOS’ tab (Database of evaluators and other persons involved in the evaluation and selection of projects) under Competences for project evaluators/IS. That list includes the first name, surname and user name of the evaluator, the date of the appointment and the sending of the application, the deadline for comments, information, whether or not the nomination was accepted, etc., along with a great deal of other information. The application for the appointment of the evaluator with user name [REDACTED] was sent on 25 January 2016, with a deadline for comments of 25 February 2016. Due to limited time, the evaluator did not accept the appointment within the time allowed and was therefore unable to evaluate the project. This is recorded by the computer system in the ‘Confirmation and Status of assessment’
columns. See screenshot from the MS2014 + computer system under the above-mentioned tab.

In light of the above the audit trail clearly exists, and corresponds to the capacity of MS2014+. We believe that the information required — in terms of the audit trail of the appointment of internal evaluators — is sufficient in the IT system.

[293] The third indent of the audit notes that the experience and education of both internal evaluators does not correspond to the subject matter of the project. We find this conclusion, which contains no further comment, to be misleading. We would first note that there are hundreds of substantially different fields under which project applications for (not only) the ‘Innovation - Innovative project’ programme can be submitted. The process of assessing external evaluators (drafting of expert assessments) is conducted outside of MS2014 + and outside records from the ‘Innovation — Innovative project’ programme. This is objectively due to the fact that agreements with external experts formed part of the arrangements for hiring experts (on an annual basis), whose output could have been used by an internal evaluator, though there was no such obligation. The individual internal evaluator has always been responsible for this. In this particular case external expertise was used. Without an internal evaluator requirement, the external expert would not have been drawn and then approached. We agree with the auditors that in some cases, including the above-mentioned project, the experience and training of the internal evaluators may fall short of what is required in view of the wide range of manufacturing sectors for the projects in question. However, this has been taken into account by the above-mentioned arrangements concerning the expert/external evaluators, as confirmed by the Commission’s auditors themselves. All requests for external expertise given in this way have been recorded in a summary table on the internal disk of the Ministry of Industry and Trade.

[294] An analogous situation to the internal evaluators is the selection of experts/external evaluators, who are drawn according to the relevant CZ-NACE projects reflecting the project’s main focus and on the basis of matching their expertise with a CZ-NACE project. The expert is always drawn along with a replacement, who takes the expert’s place when the latter rejects the appointment on grounds such as conflict of interest, lack of expertise for a particular type of project, or failure to communicate or meet the deadline. This also arises in cases where the first expert has not responded for more than one month (the deadline had been extended by the MA OPEIC; after a final reminder from the MA, the expert asked for new supporting documents to be provided, which would mean additional information on top of the documents provided in the aid application; it was not possible to approach applicants again in the evaluation process given that the documents provided on the date of application had to be assessed, failing which equal access for applicants would have been undermined). Since the MA OPEIC had no guarantee that the situation would not arise again, it opted to use his replacement, who stood in for him.

[295] As the MA OPEIC had resolved deadline issues with the expert in question in the past, it decided to make use of the replacement, even though such a course of action would extend the evaluation process (the verdict of the evaluation was not submitted until 2 August 2016). We consider this change to have been justified because, as mentioned above, the MA OPEIC had no guarantees that there would be no repeat of the difficulties with meeting deadlines. Cooperation with the external expert was terminated and he no longer evaluated projects under Priority Axis 1.

Based on the above facts we disagree with the audit findings and request that they be amended or removed.
Finding 15.2 — Evaluation and scoring by the evaluators not properly performed and justified

[296] We do not accept the claim that the internal evaluators did not justify the points allocated and merely repeated the selection criterion wording. Most of the time spent evaluating a project is taken up by the evaluator conducting the substantive examination; the drafting of the evaluation itself is also time-consuming. Hence, the criterion definition is used as much as possible. Where the internal evaluators agree with the external evaluators, it is not inappropriate for the internal evaluator to take over the external expert’s entire reasoning.

[297] [The evaluation of] internal evaluator 2207 was based on the opinion of an expert holding the titles Prof., Ing., DrSc and who has worked since 1981 in the fields of microbiology, chemistry, medical chemistry and biochemistry. The evaluator has more than 290 publications in journals with international reach and 23 patents granted. Among other things, he also performed the role of expert in assessing grant applications under the 5th, 6th and 7th EU Framework Programme, EC, DGXIII in Brussels.

[298] [The evaluation of] internal evaluator 2823 was based on the opinion of an expert with the titles Ing., CSc and who has been active in a number of research organisations since 1961. He has more than 39 publications in international science journals and 14 patents granted. He also has experience as a private consultant with the 6th EU Framework Programme.

[299] No information is provided on the qualifications and experience of the auditors in the field of food or similar. We would therefore express doubts as to whether, and the extent to which, they are competent to carry out a substantive assessment. We would also state that both experts undeniably have considerable experience of EU Framework Programmes, one of them even as an evaluator. The legitimacy of the auditors’ criticisms of the external auditors’ assessment is therefore highly questionable. We also feel that very brief comments on the various points criteria, in view of the selection criteria annexed to the Call, have no impact on the overall substantive assessment of the project. What is important is the overall final opinion of the expert/assessor.

[300] Despite the above doubts about the auditors’ competence to carry out a substantive evaluation of the projects, we do not accept the conclusion that the project only reaches innovation ranking 4, since the innovated products are already produced by the applicant’s competitors. In the introduction to Finding 8 (and this is also relevant to findings 15, 16, 18 and 19), we provide the definition of innovation taken from the OECD Oslo Manual 2005, which states that the minimum requirement for innovation is that the product, process, marketing or organisational method be new (or substantially improved) for the undertaking. We use a definition of innovation used by an important international organisation whose documents are generally considered to be of a high professional standard and are known and used around the world. Given the relatively modest technical and technological level of Czech industry, progress at undertaking level is also needed, in particular when it is linked to own R&D or technology transfer. Comparison with competitors applies in cases where the product being introduced and the production process is completely new to the applicant and there is no link with the products and production processes used by the aid applicant (it cannot be assessed otherwise), which is not the case with the project in question. Under this definition, innovation is compared with the aid applicant’s existing production and not that of its competitors or other undertakings operating in the same field. We would also point out that the way in which both experts assessed the innovation ranking indicated that the binary criterion had been met.

[301] We would also point out in this connection that the assessment of innovation ranking on the Valenta scale is very much a Czech phenomenon that has undergone a series of
changing interpretations since Professor Valenta first published it in the 1960s. The boundaries between the various rankings are somewhat blurred and may not be clear in all cases. Independent assessment by two expert evaluators is therefore becoming increasingly important.

[302] Regarding the innovation scale, the Commission's auditors state that on 15 January 2016 the applicant was invited to change the innovation ranking to 6, with the comment that 'the operation can be supported when it achieves innovation ranking 6'. The communication stated:

'Dear applicant,

The full application has been returned for rectification with the following requirements by no later than 22 January 2016.

1. As part of the feasibility study, key activities and indicators please provide information, number of binding indicators/standard indicators. 2. For key activities, you have one product, one process. The study in chapter 3.3 sets out three product innovations and four process innovations, and a value of 4 is given on the form for indicator 22501. The starting date for the indicator value must correspond to that of the project's launch, i.e. 1 July 2015.

3) For the financial plan, please correct the date of submission to the date of completion of the project's implementation.

4) Please correct the timetable of the project in Chapter 7 of the business plan in accordance with the timetable in the system. Describe.

5) Provide prototypes and completed R&D. Further demonstrate R&D. 'In the case of economically linked entities R&D activities in a joint R&D centre shall be considered as own R&D provided that the applicant is able to demonstrate, for example in the form of an internal directive or contract, that they are entitled to benefit from the R&D results of that centre.' Please specify whether this is a process or product prototype.

6) Projects may be supported provided that at least innovation ranking 6 has been achieved. Please state ranking 5-6.

We would also point out that in the event of non-compliance with the above deadline your aid application will be excluded from further evaluation.

Thank you.'

[303] The project manager merely drew attention to the conditions set out in the basic programming documents, i.e. in the call and the selection criteria to be met by the project for it to receive aid. It does not remotely follow from the above text, as the Commission auditors state, that the aid applicant is invited to change the innovation ranking. Project managers, whether or not they are aid applicants from the AGROFERT group, always warn aid applicants of the differences between aid applications submitted and programme documents (this is entirely normal practice).

On the basis of the above, we cannot accept the preliminary audit findings and request that they be amended or removed.

Finding 15.3 — Insufficient audit trail from the meeting of the selection committee

[304] In the introduction to the reasoning for finding 15.3, we would point out that the
members of the selection committee are required to comply with the statute of the MA OPEIC’s selection committee (cf. observations on finding No 10), which, inter alia, sets out the selection committee’s powers and competences, and the reasons why it is possible for a project to be referred back to the committee’s concerns (points 8 (a), (b) and (c)) or why a project has not been recommended (points 7(a) to (f)). During the first discussion the selection committee proceeded in accordance with point 8 (b)) ‘the selection committee shall be entitled to refer a project back owing to its concerns where it had serious doubts as to the relevance of the report of the internal assessor/arbitrator or part thereof, and where confirmation of such doubts would clearly lead to the project not being recommended for financing’. The selection committee responded to a request for comments on how the R&D results are used in the project and how the R&D results are substantiated in relation to the functional prototype/sample. Even though the selection committee did not receive a satisfactory answer, one evaluator did not answer the request for comments, and the other stood by his initial observations, at its second meeting on the above-mentioned document the selection committee was unable to recommend the project because none of the conditions under points 7(a) to (f) had been met. The selection committee approved the project at its meeting of 21 December 2016 on the basis of the comments of the two internal evaluators, who stood by their assessments. The reports were approved by the approver, who confirmed that they were formally correct.

On the basis of the above, we cannot accept the audit findings and request that they be amended or removed.

Finding 15.4 - Character of the resulting products not innovative

[306] The auditors’ findings are, in principle, inaccurate and incorrect. We would point out that the applicant complied with all of its requirements under the Call. None of the calls under the ‘Innovation - Innovative project’ programme lays down that similar, functioning solutions in use elsewhere cannot be transposed into Czech conditions. Indeed, this is recognised in the Innovation programme as one of the possibilities of innovation under Czech conditions.

[307] This claim is based on the text of the selection criteria, where binary criterion No 3 refers to R&D activities in groups: ‘In the case of economically linked entities R&D activities in a joint R&D centre shall be considered as own R&D provided that the applicant is able to demonstrate, for example in the form of internal guidelines or a contract, that they are entitled to benefit from the R&D results of that centre.’ This binary criterion, as well as individual criteria such as C4 Degree of novelty of the end product in relation to the market, where points are also assigned for the category ‘new to the company’. [translator's note: unfinished sentence in original text]

[308] In its findings, the Commission auditors invoked CJEU case-law, in which undertaking (firm) means an entity under joint control. It is generally accepted that courts such as the CJEU have the power to interpret legislation. Hence, where the term ‘undertaking’ or ‘firm’ appears in law - be it national or EU law - the courts are entitled to adopt an interpretation of that term. The purpose of interpreting legislation is primarily to achieve an ‘objective’ sense of the sections of the legislation in question that have been interpreted. The interpretation is
usually consolidated over time in case-law and changes are usually made only when there is a substantive alteration in circumstances.

[309] However, as mentioned above, this jurisdiction concerns the interpretation of legislation. The Call for the Innovation programme is absolutely not a piece of legislation and can therefore clearly use terms differently from the way in which they are used by the CJEU. The Call - and its annexes, i.e. including the assessment model - is a document drawn up for the general public. It cannot therefore be objectively expected that people will be aware of the CJEU's interpretation of all possible terms. In the wording of the Call, terms are used in their general meaning as used by the general public in the Czech Republic, except where it was necessary to refer to the law or any other legal document (i.e. apart from where the wording of the Call must meet the mandatory requirements of Czech or EU legislation). Regarding the issue of assessing SMEs, the Call naturally contains a great deal of reference to the relevant legal provisions, so as to make it clear what requirements must be met by potential applicants.

[310] No legislation (either in the Czech Republic or the EU) provides that a term understood in one way in legislation cannot be used with a different meaning in a non-legislative text. Furthermore, no legislation to which the MA is bound provides that, for the purposes of the selection criterion, the term 'firm' is to be read and interpreted as it is by the CJEU.

[311] In the business plan the applicant even cited a number of technology transfers within the Czech Republic. The description (paragraph 3.5 Use of R&D results in the project) has a point II entitled 'Cooperation with German partners'. The German experience under Czech conditions does not in itself justify the claim that the intention can be transferred without technical adjustments that create added value. The activities described in the project application fully correspond to the definition of innovation used in the OPEIC. The MA OPEIC has no expert documentation to conduct a retrospective assessment of the applicant's technology or any companies linked to the applicant, or any expert reports to confirm this. For the evaluation, the information submitted by the aid applicant at the relevant time constitutes a fundamental basis. As the applicant himself declares cooperation with the German partner, this does not have to be treated as secret/concealed information. It can therefore be inferred that the applicant was able to discern the boundaries between the technological processes throughout the AGROFERT group.

[312] We would also point out that the evaluation of the projects submitted under a particular call takes place at a time and place on the basis of the evidence available at that time. After a certain period of time and after completion of the projects in question, and hence with knowledge of the results achieved, it is clear that the evaluators could reach different conclusions. However, this would constitute a gross breach of the equal treatment of applicants and is therefore totally inadmissible.

For the above reasons, we therefore do not accept the proposed measures and recommendations, and we call for their removal.

Conclusion of the Commission services:

The finding is maintained and further clarified as follows.

The Commission services have analysed the Member State's reply and maintain the position that the project should not have been recommended for financing by the selection committee and, consequently, is not eligible for co-financing. The analysis of the Member State's reply and additional argumentation supporting this conclusion are set out below.
In this regard, and to address concerns raised in respect of the auditors' competence in this area, the Commission services invited three highly experienced external experts, who are also evaluators of the Horizon 2020 programme, to re-perform the evaluation for the selection of this operation, while ensuring independence of the evaluation process. One is an expert in technical disciplines (DSc, PhD, academy professor in technical disciplines, with over 20 years of experience in the field and with a substantial number of publications), the other is an expert in agriculture and food production (14 years of experience in the field and with a substantial record of publications) and the last one an expert in chemistry (academy professor in chemistry, expert in bread baking processes, over 40 years of experience in the field and a substantial record of publications). Each expert has evaluated independently the project and confirmed the conclusions made in the draft audit report. Therefore, the Commission services reiterate their position that the operation was not selected in line with the provisions of Article 125(3) of the CPR and is ineligible. Their conclusions confirm the position of the Commission services that the project should not have been selected and are incorporated in the analysis below.

In order to address clearly the Member state's reply, the Commission services renumbered initial points 1-4 from the draft audit report.

15.1 Introductory comments and analysis of the Member State’s reply

15.1.1 Research & Development related to the product innovation

The Member State’s reply refers [c.f. point 287] to the Research & Development activities related to the product innovation such as literary research, laboratory testing, quality testing and practical testing.

The Czech authorities claim [point 288] that the fact that these activities have been carried out is proven by the:

i. framework contract for partnership and cooperation in research related to bakery products (signed in February 2015); and

ii. the treaty on intellectual property rights (signed in March 2015);

both of which were signed with The University of Chemistry and Technology Prague (Vysoká škola chemicko-technologická v Praze – ‘VSCHT’).

Furthermore, the Czech authorities claim [point 288] that functional samples were proven based on product specifications, which include physical, chemical and sensory requirements, and the laboratory and sensory assessments.

Firstly, the Commission services point out that, according to the OECD Frascati manual, chapter 2.3.1:

*The basic criterion for distinguishing R&D from related activities is the presence in R&D of an appreciable element of novelty and the resolution of scientific and/or technological uncertainty, (i.e. when the solution to a problem is not readily apparent to someone familiar with the basic stock of common knowledge and techniques for the area concerned).*

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Consequently:

‘One aspect of these criteria is that a particular project may be R&D if undertaken for one reason, but not if carried out for another, as shown in the following examples:

[...]  
- The keeping of daily records of temperatures or of atmospheric pressure is not R&D but the operation of a weather forecasting service or general data collection. The investigation of new methods of measuring temperature is R&D, as are the study and development of new systems and techniques for interpreting the data.
- R&D activities in the mechanical engineering industry often have a close connection with design and drawing work. In small and medium-size enterprises (SMEs) in this industry, there is usually no special R&D department, and R&D problems are mostly dealt with under the general heading ‘design and drawing’. If calculations, designs, working drawings and operating instructions are made for the setting up and operating of pilot plants and prototypes, they should be included in R&D. If they are carried out for the preparation, execution and maintenance of production standardization (e.g. jigs, machine tools) or to promote the sale of products (e.g. offers, leaflets, catalogues of spare parts), they should be excluded from R&D.’

As these aspects are often confused, the explanation in brackets specified by the MA EIC under selection criterion B.2 ‘Cooperation with public research institutions or universities in the area of research and development activities in the last 5 years’:

- ‘At least one contract (e.g. measurement, testing)’

may be confusing for evaluators as they may treat the term ‘tests, measurements’ as a sufficient condition to meet the Research and Development criterion, which would be a significant misunderstanding.

Taking this into account, the Commission services consider the following as regards the alleged Research & Development activities:

1) **Research on literature on salt and practical analyses of wheat flour with various salt additions**
   
   This cannot be accepted as real research activity since it concerns routine quality testing performed to control the product quality for any kind of food production.

2) **Quality testing of wheat flour for producing toast bread**
   
   These tests are routinely performed measurement and testing activities without any element of novelty and the resolution of scientific and/or technological uncertainty.

3) **Proposal for simplified recipe and procedure for technological measurement of the dough for making toast bread, with the potential for use in normal baking with normal amount of salt and with a reduced amount of salt**

4) **Practical testing of reduced amount of salt**

   Both of the activities mentioned in point 3) and 4) are typical service or quality testing activities, which are in use in all industrial bakeries and are not considered as research activities by the OECD or by the Commission.

In conclusion, none of the activities specified above can be considered as Research & Development activities.
Secondly, the information provided by the applicant in its grant application does not sufficiently justify the claimed cooperation on Research & Development. According to the referred Framework contract for partnership and cooperation in research related to bakery products with the VSCHT, cooperation within the meaning of this contract should be implemented based on the individual contracts, which should specify rights and obligations. It needs to be mentioned that no contracts were submitted to the Commission services to prove any Research & Development activities, nor were any contracts submitted by the applicant in its grant application.

Furthermore, the Treaty on intellectual property rights with VSCHT does not prove any Research & Development activities. This treaty only defines the rights and obligation for both parties for cases when, during the cooperation, intellectual property rights are created.

Moreover, it is evident that the abovementioned contracts (framework contract and treaty) were concluded between the beneficiary (Pekárna Zelná louka, a.s.) and VSCHT. However, from this cooperation, the existence of a functional sample has not been proven in the application. The product specifications, presented by the company Penam, a.s. which, according to the Czech authorities, provided proof of the functional samples, are not acceptable for the Commission services as there is no evidence that these product specifications are the result of the Research & Development activities in the company Penam, a.s.

The abovementioned framework contract was concluded on 16 February 2015 and the Treaty on intellectual property rights was signed on 1 March 2015. The beneficiary submitted the application on 16 June 2015. Therefore, the documents submitted in the project application do not prove that any Research & Development cooperation took place between 16 February 2015 and 16 June 2015.

15.1.2 Research & Development related to the process innovation

The grant application specifies that the process innovation consists of the introduction of clean room technology. The Research & Development activities mentioned by the Czech authorities in their reply [i.e. activities mentioned in point 289] are copied from the first page of the document ‘Documentation proving the finalised research’.

In this regard, the project application does not prove that the clean room technology has been subject to the Research & Development activities carried out by the company Penam, a.s. Furthermore, from the submitted documents it is even not clear whether the contract with the company I.A.N. TECHNIC spol. s r.o. has been concluded and what the subject matter of this contract was. There is not even proof that the alleged technology was delivered to the company Penam, a.s. Furthermore, there are only records from testing, but there is no link to any technology on which the testing was carried out. Moreover, the alleged transfer of technology is not supported by any transfer of the intellectual property rights, as required by the selection criteria.

In addition, according to the OECD Frascati manual, chapter 2.3.4:

'A prototype is an original model constructed to include all the technical characteristics and performances of the new product. For example, if a pump for corrosive liquids is being developed, several prototypes are needed for accelerated life tests with different chemicals. A feedback loop exists so that if the prototype tests are not successful, the results can be used for further development of the pump.'

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However, none of the activities listed by the Czech authorities in their reply can be considered as a proof of the completed research, resulting in the existence of a functional ‘clean room’ prototype for the following reasons:

a) The presented clean room technology was not a result of own Research & Development, the Research & Development results created during the cooperation or the transfers of technology, but it was simply a purchase from a manufacturer;

b) The tender process on the purchase of the cooling technology by the parent company of the beneficiary (Penam, a.s.) was accompanied by the exact tender price (CZK 12,905,718.43), the output specification (1,000 pcs of bread per hour, 2,000 pcs of veils per hour), the warranty period (12 months) and the life cycle of the clean room (20 years). These parameters demonstrate that the purchased technology was not a prototype (i.e. early sample, model, or release of a product built to test a concept or process), but rather a technology for mass production by the company Penam, a.s.; and

c) The description of the clean room part as a prototype is strongly misleading. The term prototype implies that it is only used as a test device to gain information on the performance parameters of final version to be built later on, used for routine mass-production of bread. Prototypes as such are not to be used for the later routine production process.

The Commission services reiterate that the tender for a purchase of the pilot line for the bakery in Olomouc, its delivery and standard testing and tuning of the installed technology cannot be considered as a research activity.

15.1.3 Impact on the binary criteria A.3

Binary criterion A.3 required a link of the operation to Research & Development activities that should fulfil the following conditions:

- *the development has been finalised;*
- *the operation uses the results of own Research & Development, the Research & Development results created during the cooperation or the transfers of technology;*
- *in case of own Research & Development or the Research & Development results created during the cooperation the applicant must prove the existence of the functional prototype or the sample;*
- *in the case of the transfer of technology the applicant must prove the existence of the functional prototype or the sample and this transfer must be contractually supported.*

Based on the Member State’s reply [c.f. points 283 – 290] it is not possible to identify the operation’s link to real Research & Development activities. Adequate documentation confirming that the Research & Development was completed were not submitted by the Czech authorities in their reply. The Member State did not provide any proof of the beneficiary’s Research & Development, either for the product or for the process, in its grant application. The evidence that the operation uses the result of its own Research & Development, the result of the Research & Development resulting from cooperation, or the transfer of technology in the implementation of the project was not provided. The beneficiary did not demonstrate in its grant application the existence of a functional prototype/sample. The Czech authorities did not provide any proof that technology was transferred.
For these reasons, the Commission services reiterate that the operation failed to meet binary criterion A.3 (all four sub-criteria) and therefore should not have been selected.

15.2 Insufficient audit trail and non-compliance with internal rules in relation to internal evaluators and external experts

Firstly, the Commission services consider the Member State’s reply [point 291] to be contradictory. On one hand, the Czech authorities claim that the selection of the internal evaluators was carried out randomly. On the other hand, they admit that due to the lack of evaluators the operations were allocated to the internal evaluators on ad-hoc basis. Therefore, this confirms the Commission services’ observation that the internal evaluators were not selected randomly.

Secondly, the Commission services accept that a certain level of audit trail is present in the system MS2014+ as regards the communication with the internal evaluators. The Czech authorities state that the request for evaluation was sent to the internal evaluator no 2208 on 25 January 2016 with a deadline to reply by 25 February 2016 and that this evaluator could not accept the request for the evaluation due to time restrictions. However, the Czech authorities have not provided the justification by the evaluator no 2208 in this regard. Moreover, the new internal evaluator no 2823 was selected by the MA on 22 June 2016, (i.e. almost 4 months after the referred deadline), without explaining why.

Thirdly, the Commission services acknowledge the Member State’s reply related to the nomination of the external experts. The Commission services take note of the Member State’s explanation in relation to internal evaluators’ experience and their right to request external expertise in line with the OP manual. Nevertheless, the Member State in its reply states:

‘In this particular case external expertise was used. Without an internal evaluator requirement, the external expert would not have been drawn and then approached. We agree with the auditors that in some cases, including the above-mentioned project, the experience and training of the internal evaluators may fall short of what is required in view of the wide range of manufacturing sectors for the projects in question. However, this has been taken into account by the above-mentioned arrangements concerning the expert/external evaluators, as confirmed by the Commission’s auditors themselves.’

However, there is no audit trail that any of the internal evaluators requested an external expert. Moreover, as explained above, the internal evaluator no 2208 did not accept the appointment and a new internal evaluator no 2823 was selected on 22 June 2016. Meanwhile, two external experts (i.e. external expert 1 and 3) were selected by the MA even though, at that time, the second internal evaluator appointment had not yet been confirmed. This clearly contradicts the Member State’s statement that: ‘Without an internal evaluator requirement, the external expert would not have been drawn and then approached’ (point 293 of the Member State’s reply). Therefore, the Commission services reiterate their conclusion that there is no audit trail to demonstrate how, why or by whom the external experts were requested.

Finally, the Commission services take into account the statement of the MA EIC that there were deadline issues with external expert 1 in the past and that the MA EIC therefore decided to replace this expert.
15.3 Evaluation and scoring by the evaluators not properly performed and justified

The Czech authorities explain that 'the drafting of the evaluation itself is time-consuming. Hence, the definition of criteria is used as much as possible. Where the internal evaluators agree with the external evaluators, it is not inappropriate for the internal evaluator to take over the external expert's entire reasoning.'

The Commission services agree that quoting the external experts reasoning is pertinent and useful, but noted that for the evaluation of external evaluator 2, no explanation was provided for part C of the selection criteria ('Necessity and relevance of the project') and the evaluation sheet prepared by internal evaluator no 2823 included only copied definitions of the selection criteria. This approach is not in line with the OP EIC Manual, as explained in the initial finding and is not explained in the Member State’s reply.

The Commission services provide its position related to point 300 of the Member State’s reply in point 15.5 of this report (i.e. previously in the draft audit report point 4 'Character of the resulting products not innovative').

In reply to point 301 of the Member State’s reply concerning the Valenta scale of innovation, reference is made to our analysis under finding no 8. In addition however, the Commission services consider that the table presented in Annex 4 (Selection criteria) of the Call for operations no 01.15.014 over-simplifies the Valenta scale. Moreover, the wording contained in it is out somewhat outdated in that it is not very nuanced or precise (e.g. using terms such as 'accelerated belt', 'faster machine', 'machine with electronics' or 'a jet blast'). Consequently, this table could potentially mislead evaluators and result in inconsistent evaluations.

In order to establish clear and objective guidelines for the assessment of applications, it is highly recommended to use a scale enabling the assessment of innovation based on consistent criteria, using current knowledge and up-to-date solutions, in particular to use the regularly updated Oslo Manual\(^64\) and the Commission definitions.

In reply to points 302-303 of the Member State's reply the Commission services accept that the project manager merely drew attention to the conditions set out in the programme documents, when referring to the fact that 'operations may be supported when reaching level 6 of innovation. Currently you state level 5-6.'

Finally, the three independent expert re-evaluations carried out by the experts contracted by the Commission services, before having access to the initial evaluation and replies of the Member State, scored the application with 30 out of 100 (65 and 63 by the Member State’s evaluators) for a minimum required of 60 points.

15.4 Insufficient audit trail from the meeting of the selection committee

The Commission notes the reply of the Czech authorities and in particular the statement that the MA EIC and the selection committee decided to select this operation despite the fact that the selection committee had not received satisfactory answers to questions that it had raised from the two internal evaluators, one of whom did not even reply to the committee.

On 26 October 2016, the selection committee returned the operation to the internal evaluators in accordance with Article 2(8)(a) of the Statute of the selection committee (annex ‘D4_01_M_Jednací řád a statut VK’ of the OP Manual). Under this article, the selection committee is entitled to refer the operation back to the internal evaluators for explanations, owing to its concerns, solely for the following reasons:

a) where it has serious doubts as to the relevance of the report of the internal evaluator/arbitrator or part thereof, and where confirmation of such doubts would clearly lead to the project not being recommended for financing.

The Czech authorities confirmed in their reply [point 287] that this was the reason for requesting additional clarifications from both internal evaluators.

The clarifications needed related to the (binary) exclusion/selection criterion A.3 (‘Link of the operation to Research & Development activities’). In particular, the selection committee requested the evaluators to explain, ‘How are the Research & Development results in relation to the functional prototype/sample documented?’. Their non-fulfilment would automatically lead to the rejection of the operation. Although, the selection committee did not receive any assurance from the internal evaluators that this exclusion/selection criterion had been fulfilled, the operation was nonetheless approved by the committee.

The Czech authorities’ reply states that the selection committee had no other possibility than to approve the operation in question. The Commission services do not agree with this statement. In accordance with Article 2(7) of the Statute of the selection committee (annex ‘D4_01_M_Jednací řád a statut VK’ of the OP Manual):

‘the selection committee has the power not to recommend, or not to authorise, the projects to be supported from OP EIC, but only for the following reasons:

[...]

f) in case of proven misconduct/excesses in the evaluation of the project by one of the evaluators [...]’.

As explained in the finding, neither evaluator responded to the question from the selection committee as regards the binary selection criterion no A.3. Therefore, as the committee had serious doubts concerning the report of the internal evaluators, where confirmation of such doubts would clearly lead to the project not being recommended for financing, the Commission services consider that the selection committee should not have selected this project in the absence of satisfactory replies from the evaluators, or alternatively a re-evaluation.

In this regard, and despite the managing authority’s assertion that ‘the selection committee has no power to reassess projects’ (section 305), the Commission services note that under Section 6 of the Rules for the selection of operations of the OP Manual (annex ‘D_01_M_Pravidla pro výběr a hodnocení projektů’):

‘The managing authority of the OP EIC shall remove the evaluator, a member of the evaluation and the selection committee from the system, in particular where:

[...]

- has demonstrated the lack of expertise in the evaluation (poor evaluation) or during the participation in the selection committee; [...]’.

As explained above, the beneficiary did not prove in its grant application the results of own Research & Development, the Research & Development results created during the
cooperation or the transfer of technology. Consequently, this project should not have been selected.

15.5 **Innovativeness of the resulting product / process**

The Commission services acknowledge the Member State’s reply [points 300 and 306-312] and take into account that the product, process, marketing or organisational method to be considered as ‘innovative’ means that the result of the project is new (or substantially improved) for the undertaking.

In reply to point 300 of the Member State’s reply, the Commission services consider that, in accordance with the Call for operations no 01_15_014 Innovations, the objective of the call is as follows:

> 'INNOVATION — Innovative project aims at enhancing the innovation performance of domestic firms and increasing their competitiveness by increasing the use of unique know-how from a larger or lesser degree arising from collaboration with the academic and research sector, expanding firms’ know-how for self-innovations, enhancing the efficiency of internal processes in innovation management, in order to increase the number of companies mainly in the position of technology leaders, to develop and implement new competitive products on the global market and to strengthen the capabilities of firms in the areas of high-tech manufacturing. Innovations of higher level of innovation will be supported, in particular those of V. and higher level of innovation.'

The applicant defined the purpose of the project as follows:

> 'The purpose of the project is to increase the technical value and the efficiency of the technology used for the production of toast bread and of the values of the new products (elimination of preservatives, salt reduction, renewal of shelf life, improvement of palatability). It is an acquisition of a production line with significant innovative features (storage and dosage of ingredients, vacuum mixing, a clean room, innovative production management system) enabling the realisation of new products (original own wheat yeast, 3 new types of toast bread).'

From the above description, it is clear that the beneficiary will not develop any new technology by itself, but only plan to buy the new, commercially available production line. This cannot be understood as ‘increasing the use of unique know-how from a larger or lesser degree of collaboration with the academic and research sector, expanding firms’ know-how for self-innovation, enhancing the efficiency of internal processes in innovation management’. Moreover, the introduction of the new product with slightly changed parameters does not qualify the purpose of the action as ‘develop and implement new competitive products on the global market and to strengthen the capabilities of firms in the areas of high-tech manufacturing’.

Regarding definition of innovation in Oslo Manual, point 130 and 131 specifies:

> 130. Technological product and process (TPP) innovations comprise implemented technologically new products and processes and significant technological improvements in products and processes. A TPP innovation has been implemented if it has been introduced on the market (product innovation) or used within a production process (process innovation). TPP innovations involve a series of scientific, technological, organisational, financial and commercial activities. The TPP
innovating firm is one that has implemented technologically new or significantly technologically improved products or processes during the period under review.

131. The minimum entry is that the product or process should be new (or significantly improved) to the firm (it does not have to be new to the world).

This is reflected in the evaluation system and consequently the application should receive the minimal amount of 1 point in B.4 criterion (i.e. 'new to the company').

The specific issues concerning product and process innovation for project no CZ.01.1.02/0.0/0.0/15_014/0000516 is dealt with below:

Regarding the **product innovation**, the so-called innovative product described in the proposal is characterised by using fermented wheat, no preservatives and a reduced amount of common salt, aimed at producing more healthy products. These declarations are not fully justified in the grant application. Three small variations in the type of toast bread are not considered under the OECD approach as innovation (e.g. different fashion clothes are also not accepted as innovation in the clothing area).

According to the Commission services, for the reasons outlined below, under the Valenta scale the new products in question represent only Level 4 of innovation, i.e. 'Qualitative adaptation, involving qualitative adaptation of the element subject to innovation to the quality, but also quantity parameters of other elements of a business unit. This includes, for example, adapting the shape of the components of a future product to the technical parameters of the machine on which they are produced. This means increasing the manufacturability of a design').

The Commission's external experts fail to see salt reduction as an important or significant improvement of an established product, which is mandatory to be regarded as a product innovation. Any Research & Development documentation (or submitted lab protocol) to prove activities in the area maintaining the palatability and good taste (which is lost without any salt) is missing from the project application. The beneficiary does not claim any salt reduction on their toast bread labels. The innovation to reduce the salt content for health reasons is also not innovative. This decision simply follows demands from the Commission and consumers.

Adding no preservatives to the bread also has a lower level of innovation since it reflects a general trend and increasing regulation. The classical chemical preservatives are replaced by natural compounds. The addition of sour dough made from fermented wheat has a similar positive impact on the shelf-life and has been used for centuries.

Moreover, the alleged preservative-free toast bread produced by the beneficiary still contains, according to its label, sodium acetate (C2H3NaO2 or E262) which is popularly used in food production as a preservative and stabiliser. This means that one of the claimed innovations, namely a preservative-free product, has not been transformed into practice.

Regarding the **process innovation**, according to the Commission services, under the Valenta scale the new process also represents Level 4 of innovation, i.e. 'Qualitative adaptation, involving qualitative adaptation of the element subject to innovation to the quality, but also quantity parameters of other elements of a business unit. This includes, for example, adapting the shape of the components of a future product to the technical parameters of the machine on which they are produced. This means increasing the manufacturability of a design'. The new process is based on a commercially available production line, including all the parameters. In this regard, only a certain qualitative adaptation can be observed in the process, which corresponds to the 4th level of innovation according to the Valenta scale.
The project description explains the innovative features of the process as 'storage and dosage of ingredients, vacuum mixing, a clean room, innovative production management system' as well as a cooling procedure aimed at increasing the shelf-life of products.

Regarding storage and dosage of ingredients, the production management system innovativeness was not sufficiently justified. Bread cooling has been known and used for many years. Some level of innovativeness can be attributed to vacuum mixing and the clean room. However, on the other hand, vacuum mixing methods are actually recommended for the food industry, including bakeries. Therefore, the applicant would only have been able to justify the innovativeness of the new production line with the presence of the 'clean room'. However, clean rooms are now a necessary part of the technology for food production. In the food industry, clean rooms are commonly used to avoid contamination of products. This kind of control must be carried out carefully and be present in each production phase. Clean rooms must be designed to minimise generation and retention of aero transported particles.

To ensure the highest level of control, clean rooms for the food industry are characterised by specific physical requirements regarding humidity, temperature, and pressure. Only in this way can the purity of products be guaranteed. A clean room for the food industry is commonly used after the chemical, thermic or physical treatment of the food and aims at protecting specific processing procedures such as cutting, portioning, slicing, grating, dicing and packaging of solid foods. Liquid products have to be protected during filling, crimping, sealing and bottling.

Clean rooms for the food industry are crucial for protecting bakery products and cold cuts.65

The term 'clean room' means that the room requires special air purity determined by the permissible amount of semi-micron solids or bacteria or viruses in the air. The permissible amount of pollution is determined per cubic foot of air, i.e. 0.283 m. Generally, the 3 cleanliness classes 10, 100 and 1000 can be distinguished. Air cleanliness class 10 is the highest and it is achieved only on a small surface in specially separated parts, (i.e. digesters with sleeves). Permissible air pollution can be one micron (or smaller solids) per cubic foot of air. A cleanliness class of 100 means acceptable air pollution in the form of several individual semi-micron impurities per cubic foot of air. Spaces of this quality are also limited to individual parts of the workshop's independent equipment, i.e. to digesters with sleeves. Cleanliness class 1000 means cleanliness that is almost flawless to meet the requirements of operating rooms in surgical hospitals.

The applicants did not submit any results of air analysis to confirm that the clean room installed in the bakery targeted by the project has any distinguishing features in terms of air cleanliness that would lead to the conclusion that indeed some level of innovativeness was achieved.

Therefore, the argument that the production process acquired by the applicants is innovative at the level indicated by the call, is not accepted.

The Commission services reiterate that the evaluation and scoring of this project was inadequate, and that the innovation level specified by the applicant should have been classified at a maximum of level 4 of the Valenta scale. On that basis, the project should not have been selected.

Moreover, for the reasons described above, the Commission's external experts concluded that the project in question also failed the following binary criterion:

Binary criterion A.2 'The project bring a product innovative or process innovation of at least of the 5th innovation level of Valenta for SMEs and, respectively, at least 6th innovation level of Valenta for large enterprises.' Furthermore, as explained above, based on the Member State's reply and the grant application it is not possible to identify the link of the operation to actual Research & Development activities. Adequate documentation confirming that the Research & Development was completed was not submitted by the Czech authorities nor proof of the beneficiary's Research & Development in its grant application, either for the product or for the process. Evidence that the operation uses the result of its own Research & Development, the result of the Research & Development resulting from cooperation or the transfer of technology in the implementation of the project was not provided. The beneficiary did not demonstrate in its grant application the existence of a functional prototype/sample. The Czech authorities did not provide any proof of a technology transfer.

Finally, the Commission services noted that the innovative product specified in the project application ('Light toast bread' 500g) available on the Czech market is produced in Czech Republic and Germany under the brand name Penam. The description on the label of 'Super sandwich' wheat 750g clarifies that the same product can be produced in the Czech Republic (which is marked by the extension CZ on the label) or in Germany (extension D on the label) again under the brand name Penam.

**Overall conclusion**

Taking into account the abovementioned arguments, the Commission services reiterate their position that the operation should not have been selected by the Czech authorities and is ineligible for co-financing from the ERDF.

**Recommendation 15.01**

The managing authority is requested to correct any ineligible expenditure already declared for this operation and to cancel the public contribution to it.

**Recommendation 15.02**

The managing authority is requested to ensure that the evaluation process provides robust evidence to demonstrate full compliance of grant applications with the selection criteria. Operations for which insufficient evidence of compliance is provided in the application should be set aside and a request for further information sent to the applicant. If ultimately they are not in line with the selection criteria they should be rejected.

**Recommendation 15.03**

The managing authority is requested to confirm that the selection criteria were appropriately applied for all remaining innovative operations linked to the AGROFERT group and to apply the necessary additional corrections if needed.

**Importance:** Critical

**Body responsible:** OP EIC managing authority

**Deadline for implementation:** 2 months
Finding 16

Operation no CZ.01.1.02/0.0/0.0/15_014/0000516 (beneficiary Pekárna Zelená louka, a.s.) – error in the calculation of CBA analysis

For the CBA analysis of the operation 'Innovation line for the production of toast bread', the risk analyst reviewed only whether the results reported by the applicant seem to be reasonable. The risk analyst did not review the reality of entries submitted by the applicant in the CBA analysis.

The auditors identified that the amount of total investment included in the CBA analysis, included only the eligible expenditure of 400 mil CZK (approx. EUR 15.5 mio) and not the total operation value of 650 mil CZK (approx. EUR 25.2 mio) as indicated in the grant application. When recalculating the CBA analysis, the results would be the following:

<table>
<thead>
<tr>
<th>Total investment</th>
<th>IRR without funding</th>
<th>IRR with funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>CZK 400.000.000</td>
<td>12.76%</td>
<td>18.56%</td>
</tr>
<tr>
<td>CZK 650.000.000</td>
<td>4.79%</td>
<td>7.25%</td>
</tr>
</tbody>
</table>

The CBA analysis are filled in by the applicants directly in the MS 2014+. The system automatically shows the results of the CBA analysis. For the IRR below 8%, the system shows that the conclusion should be 'conditions fulfilled with objection'. The Commission services note that this conclusion would not have had any impact on the substantive evaluation of the operation, as the results of the CBA analysis are not further reflected in the selection criteria. As concluded already by the Commission services during the EPSA mission no REGC414CZ0018, the CBA verification has only a formal character and the correctness of the data is not reviewed. (Recommendation 04.01. The Czech authorities (MA, IB) should improve the verification of the economic capacity of the applicant/beneficiary. Verification of the CBA should be carried out as requested in the methodology and results of this verification recorded. The comments raised during the economic evaluation should be clearly recorded in the MS 2014+ and used during further stages of the project selection process. Projects where certain financial risks have been identified during the economic evaluation should be closely monitored in this respect during the project implementation and durability period. In addition, for cases where the economic/financial history and capacity is demonstrated via a different entity than the applicant itself, the Czech authorities should request sufficient guarantees from these entities or other sources in order to cover the relevant risks during project implementation and the durability period).

Action to be taken / recommendation

Importance: Important

The national authorities should set up a system to review the substance of the CBA analysis and the risks identified during this verification should be reflected at the stage of the substantive evaluation of the operations. Moreover, if one element of conclusions from the risk analysis indicates fulfilment with objection, it should be clearly stated in the internal procedures and/or in the selection criteria that this objection triggers rejection of application/return for correction at this stage of evaluation process.

Body responsible: managing authority of the OP EIC

Deadline for implementation: 2 months
Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[313] We agree with the audit comments that if total expenditure rather than total eligible expenditure were included, the internal rate of return (IRR) would fall and the system would classify the project as ‘recommend but with reservations’ (initial investment would be higher). This does not affect the resulting assessment of the applicant’s admissibility. Cost-Benefit Analysis (CBA) works on forward-looking data and with economic plans that are often offset by other, non-economic benefits of the project. Given that this is a future outlook that may change over time, the CBA is an indicative support tool for project evaluation. Projects may not be excluded from further assessment on the basis of this value.

[314] We cannot accept the auditors’ recommendation to require guarantees in cases where the economic situation of the applicant’s undertaking fulfils the prerequisites for the successful implementation of the project and where the size of the project, according to the financial analysis form, is commensurate with the economic results achieved. If it is a thriving, economically healthy company with sufficient capital, there is no reason to call into question whether it will ensure that the project will be funded and implemented.

[315] The project was also assessed by an economic evaluator (the condition was set out in the selection criteria as follows: ‘In the case of one entity seeking aid of CZK 25 million and above under one call, an economic evaluator will assess the project’s economic and financial viability.’). The project’s budget therefore meets the conditions of economic and financial viability.

On the basis of the above, we cannot accept the audit findings and request that they be amended or removed.

Conclusion of the Commission services:

The finding is closed.

The Commission services note the agreement of the Czech authorities that the CBA analysis for operation no CZ.01.1.02/0.0/15_014/000516 was calculated incorrectly and their comment that this had no impact on the admissibility of the applicant.

As regards the statement in the Member State’s reply (c.f. 314) referring to

‘the auditors’ recommendation to require guarantees in cases where the economic situation of the applicant’s undertaking fulfils the prerequisites for the successful implementation of the operation and where the size of the operation, according to the financial analysis form, is commensurate with the economic results achieved’,

no such recommendation is made in the draft audit report.

The recommendation requested was to review the substance of the CBA analysis and to consider risks identified during this analysis at the stage of the substantive evaluation of operations.

The Commission services note that, for this particular call, the CBA was only to be used as an indicative support tool for project evaluation and that projects could not be excluded from further assessment based only on the results of the CBA.
For the future, the MA EIC should ensure that any risks identified during the CBA analysis are taken into consideration at the stage of the substantive evaluation of operations.

The recommendation is closed.
Finding 17

Operation no CZ.01.3.10/0.0/0.0/16_061/0011011 (beneficiary: Ethanol Energy a.s.) – errors in the calculation of CBA analysis

Category: KR2

Sub-category: Ineligible amount

During the selection of operations the IB (Agency of the Ministry of Industry and Trade – API) carries out checks of formal aspects and eligibility of the project. Two internal evaluators are appointed for this task. One evaluator performs the evaluation and the second one reviews it. In addition, the risk analyst from the IB performs an evaluation under the criterion which relates to economic capacity (section TSA of the Manual and annex D.01_M of the Manual). The evaluation is based on data provided by the applicant in the economic capacity form and submitted as a table annexed to the application. The number of points attributed is not assessed, because it is calculated ‘automatically’ in the table. A minimum number of points of 5 out of 9 can be attributed. The IB verifies only the data entered into the table and it is purely a formal check. After formal and substantial evaluation, the application is transferred to the evaluation committee for final approval.

Even though the project CZ.01.3.10/0.0/0.0/16_061/0011011 (Ethanol Energy a.s.) was evaluated by the risk analyst of the IB ‘with an objection’ and this objection was maintained by the evaluation committee in its decision at a later stage of evaluation process, it was not taken into account by the MA, which signed a grant for co-financing of the project without addressing part of this objection. According to the analyst and the evaluation committee, due to an objection related to a large number of ineligible items included in the budget and the limit of 5% of the project value set for the cost of project documentation being exceeded, the amount of the total budget should be reduced. However, the MA only reduced the total eligible costs related to the ineligible items and did not reduce the amount of the budget dedicated to project documentation (24189.242,-CZK). As the amount for project documentation represents 5.82% of total eligible expenditure, the difference of 0.82% (CZK 1968.333,71 / approx. EUR 76.292) is considered ineligible.

Action to be taken / recommendation

Recommendation

The MA is requested to correct ineligible amount of 1968.333,71 CZK (approx. EUR 76.292) and to cancel the related public contribution to this operation.

Importance: Very Important

Body responsible: Managing authority of the OP EIC

Deadline for implementation: 1 month

Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[316] The finding includes the mixing of areas. The name of the finding - errors in the calculation of CBA - does not correspond to the error actually detected (see the second paragraph of the finding). In the first part (first paragraph), the EC auditors describe in
general terms the ongoing process in the Enterprise and Innovation Agency [sic]: an economic evaluation is carried out along with an evaluation of the CBA, where relevant, as part of the formal evaluation/admissibility assessment. The first paragraph ends as follows: ‘After formal and substantial evaluation, the application is transferred to the evaluation committee for final approval.’ This is not true. The evaluation process consists of three parts:

1. Formal evaluation and assessment of admissibility
2. Substantive evaluation (including CBA)
3. Selection committee.

[317] In other words, in cases where a project meets the formal and admissibility criteria the next stage is a substantive assessment; the final step is the discussion of the project by the selection committee.

[318] As part of its reply to Finding No 17 the MA OPEIC commented only on the part indicating possible error (i.e. second paragraph):

‘Even though the project CZ.01.3.10/0.0/0.0/0.0/16_061/0011011 (Ethanol Energy a.s.) was evaluated by the risk analyst of the IB ‘with an objection’ and this objection was maintained by the evaluation committee in its decision at a later stage of evaluation process it was not taken into account by the MA, which signed grant contracts for co-financing of the project without addressing this objection. According to the analyst and the evaluation committee, due to an objection related to a large number of ineligible items included in the budget and the limit of 5% of the project value set for the cost of project documentation being exceeded, the amount of the total budget should have been reduced. However, the MA only reduced the total eligible costs related to the ineligible items and did not reduce the amount of the budget dedicated to project documentation (CZK 24 189 242). As the amount for project documentation represents 5.82% of total eligible expenditure, the difference of 0.82% (CZK 1 968 335.71 / approx. EUR 76.292) is considered ineligible.’

[319] The precise title of budget item No 1.2.1.3 containing the project documentation is: ‘Project and engineering activity’. This means that expenditure on both project and engineering activities may be included in this line. The section on extract of eligible expenditure on page 3 of Annex 2 to the Energy savings programme, Call II - DEFINITION OF ELIGIBLE EXPENDITURE states: Project documentation costs are set at no more than 5% of the itemised budget. ‘On page 4: The costs on engineering activity in construction are set at no more than 5 % of the itemised budget’.

[320] Hence, the maximum amount spent on project documentation cannot be obtained by simple calculation from total investments. It is first necessary to identify the part of the amount entered in budget chapter 1.2.1.3. Project and engineering activity is determined on the basis of project documentation and which part of the budget is devoted to engineering.

[321] In the case of an audited project, the Annex to the project must be based on Annex 1_General Budget of Ethanol Energy and _Energy savings II_FINAL O.xlsx.

[322] The following entries are made in parts A and B:

<p>| Part A Project and project services after aid application and tendering | Note |</p>
<table>
<thead>
<tr>
<th>1.1</th>
<th>Performance Documentation</th>
<th>8,833,536</th>
<th>Documentation expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.11</td>
<td>Documentation on current state of play</td>
<td>1,944,000</td>
<td>Documentation expenditure</td>
</tr>
<tr>
<td>1.111</td>
<td>Other documentation under the works contract</td>
<td>3,000,000</td>
<td>Documentation expenditure</td>
</tr>
<tr>
<td><strong>Total - Part A - expenditure on documentation after submission of aid application and tendering</strong></td>
<td>13,777,536</td>
<td>ZV - documentation after submission of application</td>
<td></td>
</tr>
</tbody>
</table>

| Part B - ancillary budget expenditure — implementation after tendering |
|-------------------------|--------------------------|
| 2.I | Supervision of construction and installation | 3,673,706 | ancillary expenditure on implementation |
| 2.II | site facilities | 4,200,000 | ancillary expenditure on implementation |
| 2.III | Insurance | 197,100 | ancillary expenditure on implementation |
| 2.IV | Handling, labelling and packaging, transport to site | 2,268,000 | ancillary expenditure on implementation |
| 2.V | Customs expenditure and customs duties | 72,900 | ancillary expenditure on implementation |
| **Total - Part B - ancillary budget expenditure — implementation after tendering** | 10,411,706 | ZV - ancillary expenditure after submission of application |

[323] Part A + B = CZK 24,189,242. However, items in Part B do not fall under project documentation. It is therefore necessary, in order to obtain the correct calculation, to determine the ‘type’ of expenditure depending on the eligibility of the items (see Annex 2 to the Energy savings programme, Call II — DEFINITION OF ELIGIBLE EXPENDITURE, pages 2 and 3).

[324] Breakdown of said items:

| Part B - ancillary budget expenditure — implementation after tendering |
|-------------------------|--------------------------|
| 2.I | Supervision of construction and installation | 3,673,706 | Engineering activities |
| 2.II | site facilities | 4,200,000 | VRN (Other machinery and equipment, including management software, in accordance with document 1_Summary budget of Ethanol Energy and Energy savings II O.xlsx, delivered on 17 August 2017 in response to notice of disposal (classification of item unclear from the original document)) |
| 2.III | Insurance | 197,100 | Ineligible expenditure |
| 2.IV | Handling, labelling and packaging, transport to site | 2,268,000 | Ineligible expenditure |
| 2.V | Customs expenditure and customs duties | 72,900 | Ineligible expenditure |
| **Total - Part B - ancillary budget expenditure — implementation after tendering** | 10,411,706 |

[325] After a recap of the items entered in parts A and B of the budget the following results are obtained.
Project documentation: CZK 13,777.536
Engineering activities: CZK 3,673.706
Ancillary budget expenditure: CZK 4,200,000
Ineligible expenditure: CZK 2,538,000

[326] The next step is to verify whether the 5% limit on project documentation and the 5% limit on engineering has been exceeded (under Annex 2 to the Energy savings programme Call II - DEFINITION OF ELIGIBLE EXPENDITURE).

[328] Ineligible items amounting to CZK 944,377,65 were identified in parts C, D and E of the itemised budget. Budget according to 1 _General Budget of Ethanol Energy and _energy savings II FINAL O.xlsx.

Part C: CZK 210,008.728
Part D: CZK 4,648,983
Part E: CZK 3,310,030

[329] Total for budget line 1.2.1.2. Machinery and equipment including management software CZK 217,967,697. In addition to this amount, it is also necessary to add CZK 4,200,000 in expenditure on site facilities which is incorrectly stated by the applicant/beneficiary in the project documentation chapter: 'site facilities' forms part of ancillary budget costs and thus investment, i.e. in Chapter 1.2.1.2. Machinery and equipment including management software

[330] Investment in machinery and equipment for calculating the PD limit: CZK 221,223,319.35

[331] In part F Construction ineligible expenditure was detected totalling: CZK 19,575,083.30 (Annex 34: '11011_položky.pdf', annexed to the evaluation entered in the MS2014+ system, Annex 17.3).

[332] Investment in Construction works/Reconstruction and modernisation of construction works for calculating the PD limit: CZK 3,973,756.

[333] Total investment expenditure of CZK 225,197,075.35 under the itemised budget (221,223,319.35 + 3,973,756).

[334] 5% of CZK 225,197,075.35 is CZK 11,259,853.77. This means that the maximum expenditure for project documentation is CZK 11,259,853.77. As mentioned above, expenditure on project documentation is CZK 13,777,536. The difference (reduced amount) is then: 13,777,536 - 11,259,853.77 = CZK 2,517,682.23 (this figure corresponds to the reduction in expenditure on project documentation given in Annex 34 '11011_položky.pdf', which forms part of the assessment in MS2014+).

[335] Adding all the items of the reduction (see Annex 34 '11011_položky.pdf' forming part of the evaluation in MS2014+) gives the following amount: CZK 25,575,142.92 This amount is then deducted from the total eligible expenditure: 265,705,822 - 25,575,143 = CZK 240,130,679.

[336] The assessment is accompanied in MS2014+ by the following comment: ‘The internal evaluator based the evaluation of the project budget on an external opinion noting that a number of ineligible items not affecting energy savings have been found in the project budget.
The threshold of 5% of expenditure (VRN and ZRN) on project documentation has also been exceeded. I therefore propose a reduction of CZK 25,575,142 from the total eligible expenditure. The total eligible expenditure is reduced to CZK 240,130,679.05. A detailed summary of the reduced items is included as a separate annex to the evaluation.

[337] The new total eligible expenditure is CZK 240,130,679, which corresponds to the amounts stated in the project evaluation. It is clear from this calculation that all the amounts that needed to be deducted have been deducted. The project evaluation, the calculation of the reduction and the consequent reduction itself were carried out correctly.

[338] Probably due to the complexity of the calculation, the applicant did not correctly adjust the budget for the individual chapters (the Project and engineering activity chapter was reduced less than it should have been, at the expense of the Machinery and equipment chapter, including management software). The total reduction was carried out correctly. The final adjustment to the spread of items will be fine-tuned with the applicant before payment of the claim. It is necessary to transfer the item Site facilities - CZK 4,200,000 from the Project and engineering chapter to Machinery and equipment, including Management software, since this is part of the investment, as mentioned above.

[339] The resulting budget breakdown must be as follows:

<table>
<thead>
<tr>
<th></th>
<th>application CZK</th>
<th>reduction CZK</th>
<th>new CZK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction works</td>
<td>23,548,839</td>
<td>19,575,083</td>
<td>3,973,756</td>
</tr>
<tr>
<td>Machinery and equipment</td>
<td>217,967,741</td>
<td>944,378</td>
<td>221,223,363</td>
</tr>
<tr>
<td>including management software</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>project and engineering</td>
<td>24,189,242</td>
<td>5,055,683</td>
<td>14,933,559</td>
</tr>
<tr>
<td>Total</td>
<td>265,705,822</td>
<td>25,575,144</td>
<td>240,130,678</td>
</tr>
</tbody>
</table>

[340] As part of the monitoring of the payment claim, under the criterion of checklist 005583 'each item of eligible expenditure is assigned to the correct budget line', compliance is checked of the expenditure submitted in the document with the classification in the budget line. In the event of non-compliance the applicant is asked to rectify the matter by means of a system modification request. As the administration of the payment claim has been suspended pending the resolution of the audit, the applicant will be called upon to make the correction at a later date. We note, however, that the expenditure reduction was carried out according to the requirements of the selection board and the API carried out a check in accordance with the text of the Commission's concerns. The total eligible expenditure of the project is at the correct level and no irregular aid has been awarded or paid out.

We do not accept the above finding or recommendation and ask that they be amended or removed.

Conclusion of the Commission services:

The Commission takes note of the explanations provided by the Czech authorities and considers the calculations presented to be correct.

The recommendation is closed.
Finding 18

Double financing - Non-respect of Article 3(b) of the Regulation (EU) No 1301/2013 - beneficiaries under the EU ETS (Operation no CZ.01.3.10/0.0/0.0/16_061/0011011 (beneficiary: Ethanol Energy a.s.) and operation no CZ.01.1.02/0.0/0.0/17_109/0011122 (beneficiary Lovochemie a.s.))

Category: KR2

Sub-category: Ineligible project There is a following requirement under Article 3 of the Regulation (EU) 1301/2013 - Scope of support from the ERDF [...] 3. The ERDF shall not support:

(b) investment to achieve the reduction of greenhouse gas emissions from activities listed in Annex I to Directive 2003/87/EC.

REGIO provided, the guidelines (letter of 29/06/2016 (Ares(2016)3071251) and emails of 03/10/2016 (EU) and 27/11/216 (AVB) which included a detailed interpretation from the Commission and required carrying out individual assessment of the applications submitted by the beneficiaries subject of the EU ETS scheme.

Under the call nr II - dedicated to energy savings, the rules for the selection of operations included provisions that required individual assessment of the project application if the applicant is part of the European Emissions Trading System (EU ETS). The applicant was requested to briefly describe why the project activities were not concerned by the activities included in Annex I of Directive 2003/87/EC of the European Parliament and of the Council (Directive establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC, hereinafter referred to as ‘Annex I’). This description was to include:

- Energy efficiency improvement measures supported under the project and its relation to the main production systems identified among the Annex I activities.
- The amount of allowances under the EU ETS scheme to be reported on an annual basis.
- The quantity of emissions reported and the impact of project implementation on its level.

REGIO auditors did not identify any individual written assessments as part of the project application where the applicant was part of the EU ETS (link to national register of companies benefiting of the EU ETS: https://www.mzp.cz/cz/seznam_zarizeni_euts). The scope of the project was not assessed against the scope of the greenhouse gas emission certificate issued at national level and the conclusions have not been drawn by the managing authority. Under the call nr II one operation is concerned namely, Ethanol Energy a.s. (CZ.01.3.1.0/0.0/0.0/16_061/0011011). It relates to replacement, complement and modification of technological processes and technology in manufacturing for hydrolysis, and distillation that is part of the installation used for producing different chemical components by the beneficiary. This installation is fully dependant on the heat source – coal boilers (3 x15.9 = in total 47.85MW). The investment is presented as one which aims at a reduction in CO2 emissions of 23.293t/year. Under specific substantive selection criterion requiring a reduction in CO2 emissions, the application was evaluated and was given maximum points (32). Therefore, REGIO auditors concluded that that the beneficiary benefited from the support of both the ERDF and the EU ETS scheme, therefor the operation is considered ineligible as the Article 3 (3)(b) of the Regulation (EU) No 1301/2013 was not respected.

No information on the fact that the applicant/beneficiary is part of the EU ETS scheme was included in the project application, feasibility study, energy opinion or business plan. In
addition, during the assessment of the application the evaluators did not refer to the requirements of the call II rules ((9.3 1)(k); 9.3 2)(a)(b) – ‘the applicant shall confirm in the feasibility study the compliance of the proposed project with these specific conditions (Article 3(b) of Regulation (EU) No 1301/2013 the European Regional Development Fund (ERDF Regulation) and on specific provisions concerning the Investment for growth and jobs goal for project admissibility’ and they did not make any written statement in the evaluation of the application file.

Under the call nr IV – dedicated to enhancing innovation performance of enterprises, projects related to increasing efficiency of energy use or reducing the energy consumption of the applicant shall not be supported. At the same time, the project shall not violate the sustainable development principle defined in the Article 8 of the CPR and it shall comply with the EU and Czech environmental legislation (exclusion criterion no 5 of that call).

In the case of the application from Lovochemie a.s. (CZ.01.1.02/0.0/0.0/17_109/0011122), an individual assessment by the managing authority/intermediate body did not take place as far as the scope of the project is concerned against the scope of the greenhouse gas emission certificate issued at national level.

This application for co-financing relates to the introduction of an innovative solution to produce a mix of ammonium sulphate, which is the essential raw material for the production of sulphur fertilisers. However, it is expected by the applicant that as a result of the project, a significant reduction of emissions from the production of DASA — NOx, dust, NH3 will be achieved as well as electricity cost savings. The managing authority/intermediate body did not carry out an assessment of the greenhouse gas emission permit issued at national level in order to exclude potential double financing as required by Article 3 (3)(b) of the ERDF Regulation no 1301/2013.

At the request of REGIO auditors the managing authority explained that compliance of the project application was reviewed and the conclusion issued confirmed compliance with the Article 3 (3)(b) of the ERDF Regulation. However, REGIO auditors could not identify any separate document issued during the evaluation of the applications to support this conclusion. Moreover, the applications submitted in both cases did not refer to the fact that both beneficiaries are part of the EU ETS scheme monitored by national authorities and no analysis of the relevance of the content of the green certificates issued and project application were carried out.

In case the MA intends to support beneficiaries of the EU ETS scheme not listed in Annex I to Directive 2003/87/EC may be considered eligible. Reduction of GHG shall not be a direct effect of the operation support and shall not increase the output capacity of the facility supported when the EU ETS scheme operator applies for the ESIF support.

Therefore, both operations are considered ineligible in their entirety.

Action to be taken / recommendation

a. The managing authority is requested to correct the ineligible expenditure and to cancel the public contribution to the operations Ethanol Energy a.s. (CZ.01.3.1.0/0.0/0.0/16_061/0011011) and Lovochemie a.s. (CZ.01.1.02/0.0/0.0/17_109/0011122) and to provide details to the Commission.
b. The managing authority is requested to verify all other operations under the EU ETS scheme to ensure that there is no double financing.

Importance: Critical
Body responsible: Managing authority of the OP EIC
Deadline for implementation: 2 months

Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[341] As regards the project of Ethanol Energy, a.s., the installation is part of the EU ETS scheme in respect of the following activity listed in the register of activities pursuant to Act No 257/2014 on the conditions for trading in greenhouse gas emission allowances:

Combustion of fuels in installations with a total rated thermal input exceeding 20 MW, except in installations for the incineration of hazardous or municipal waste.


[342] The measure indicated in the aid application does not concern any combustion plant and, therefore, the evaluator did not request any explanation or clarification, as in such cases the activities and boundaries, including the manufacturing sub-processes, are clearly defined, or, to be more precise, in the case at issue the application concerns only a boiler room and the combustion of fuels using the relevant boilers (as opposed to, for example, the production of cement clinker or the production of pig iron, where the activities and the greenhouse gas emission allowances are dependent on more complex manufacturing processes and also on setting product benchmarks, etc.).

[343] Therefore, in the case at issue the investment does not concern an activity covered by the EU ETS scheme and the boundary has been clearly defined.

[344] Furthermore, the MA of the Operational Programme ‘Entrepreneurship and Innovation for Competitiveness’ received a guidance document from the Commission (DG REGIO), going beyond Regulation No 1301/2013 and enabling a much narrower interpretation of installation boundaries than that provided in the document ‘Guidance on Interpretation of Annex I of the EU ETS Directive’ (i.e. the EU ETS Directive of 18 March and in effect from 2013, where the definition of an installation boundary is (‘... the broadest possible’); emphasis is put on, for example, the way in which the energy efficiency improvement measures influence the main production systems (i.e. installations) listed among the activities in Annex I, namely whether or not they result in improving their production processes or increasing their capacity, or in a direct reduction in their greenhouse gas emissions (of those installations).

[345] Since the measures covered by the aid application do not concern combustion plants at all, they cannot have any impact on the main production systems, i.e. installations listed among the activities in Annex I, or, to be more precise, covered by the above EU ETS scheme. As a result, there is no direct reduction in their greenhouse gas emissions, either within the meaning of the guidance document received from DG REGIO, or pursuant to
Regulation No 1301/2013,⁶⁶ which states that:

‘At the same time, activities outside the scope of the ERDF should be defined and clarified, including investment to achieve the reduction of greenhouse gas emissions from activities listed in Annex I to Directive 2003/87/EC of the European Parliament and of the Council (4). In order to avoid excessive financing, such investment should not be eligible for support from the ERDF as it already benefits financially from the application of Directive 2003/87/EC. That exclusion should not restrict the possibility of using the ERDF to support activities that are not listed in Annex I to Directive 2003/87/EC even if those activities are implemented by the same economic operators, and include activities such as energy efficiency investments in district heating networks, smart energy distribution, storage and transmission systems and measures aimed at reducing air pollution, even if one of the indirect effects of such activities is the reduction of greenhouse gas emissions, or if they are listed in the national plan referred to in Directive 2003/87/EC.’

[346] Therefore, the activity of the combustion of fuels is not covered by the aid. The aid was granted for the activity of ethanol production, or, more precisely, for improving the energy efficiency of this activity, which is not covered by the EU ETS scheme. The activity at issue is other than the combustion of fuels, or, more precisely, this activity uses only the energy generated in the context of another activity, and that will be reduced as a result of the measure.

[347] Thus the above has been fulfilled, namely support from the ERDF is not excluded for activities that are not covered by the EU ETS scheme and that are implemented by the same operator that is covered by the EU ETS scheme in respect of another activity, and one of the indirect effects of the other activity is the reduction of greenhouse gas emissions during the activity covered by the EU ETS scheme. In simple terms, it is exactly the same as any investment measure aiming at energy efficiency of heat distribution networks because they also take place outside the boundaries of the combustion process/boiler room, and by reducing the losses, such as within the heat distribution network, greenhouse gas emissions are reduced indirectly.

[348] In case of doubts concerning a lack of assessment of the issue by an internal evaluator, we would like to point out that the issue had been dealt with by Implementation Unit P03 (the unit in charge of the issue) of the MA of the Operational Programme ‘Entrepreneurship and Innovation for Competitiveness’ for about a year and a half before it received an opinion from DG REGIO; the time allocated to that exceeded 500 hours. Moreover, the unit has its own internal evaluator, who had worked at the Ministry of the Environment for more than seven years, namely in the Energy and Climate Protection Department, Emission Trading Issues Unit.

[349] Given the focus of project CZ.01.0.02/0.0/0.0/0/17_109/0011122, of the beneficiary Lovochemie a.s., it should be pointed out that the production of a mix for the manufacturing of sulphur fertilisers does not fall under the activities covered by the EU ETS scheme. The project supported does not have any direct impact on installations or activities covered by the EU ETS scheme, or, more precisely, it is outside its system boundaries. As regards the EU ETS, the project is independent of the scheme and comprises only a shift of production from

one place to another. The only outcome might be that the production of this type of fertiliser directly at Lovochemie a.s. will result in an increased consumption of steam and other inputs of this production; however, that does not constitute any physical change that would have an impact on the allocation of free allowances. Therefore, we cannot agree with the auditors’ conclusions that expenditure under project 11122 is ineligible.

[350] In addition to the above, we would also state the following facts. Article 3(3)(b) of Regulation 1301/2013 provides that the ERDF is not to support: investment to achieve the reduction of greenhouse gas emissions from activities listed in Annex I to Directive 2003/87/EC. This Regulation has been implemented into Czech lay by means of Act No 383/2012 on the conditions for trading in greenhouse gas emission allowances. Under finding 18, it is stated that although the project’s intended aim was a (significant) reduction in emissions from the production of NOx, NH3 and dust, during the assessment (SCOPE) no evaluator specifically dealt with the project’s framework in comparison to the framework (SCOPE) for greenhouse gas emissions as they are registered and assessed at national level. It is important to note in this regard that at national level, under Act No 383/2012 on the conditions for trading in greenhouse gas emission allowances, record-keeping pursuant to Annex 1 concerns solely the production of the substances concerned. As regards this project, the activities listed in Annex 1 that are thematically close in terms of wording are combustion of fuels in installations with a total rated thermal input exceeding 20 MW (in line with the Act, Lovochemie, a. s. has registered a coal-fired and a gas-fired boiler), nitric acid production (the company has not registered the production of nitric acid) and production of ammonia (the company has not registered the production of ammonia). The project at issue foresees certain reductions in consumption per produced unit. Such savings are entirely at odds with the emission trading policy. Any links between the project and the Act are completely irrelevant.

[351] The above statements can also be supported by the information given on page 22 of the Business Plan, which states: ‘The Business Plan under preparation aims at replacing the input raw materials that are less accessible and less cost-effective (ammonium sulphate) with more accessible raw materials (sulphuric acid and ammonia) by expanding the UGL technology line with a unit for the production of a slurry of nitrogen fertilisers with sulphur content. (SA unit), i.e. the so-called wet process of the production technology. This slurry will be the input raw material for the UGL unit for the production of two types of granular fertilisers, namely DASA 26+13S and DASA 25+12S. The project submitted therefore aims at expanding this production unit with a view to manufacturing sulphur fertilisers only from sulphuric acid and ammonia as substitutes for ammonium sulphate.’

[352] As regards Recommendation (b) to the finding at issue, the MA of the Operational Programme ‘Entrepreneurship and Innovation for Competitiveness’ drew up an analysis.

Based on the above facts we disagree with the audit findings in respect of the projects at issue and request that they be removed.

Conclusion of the Commission services:

The finding 18a is maintained.

REGIO auditors note the explanations of the managing authority regarding operation no. CZ.01.3.10/0.0/0.0/16_061/0011011 (beneficiary: Ethanol Energy a.s.) that the scope of the operation co-financed by the ESIF does not concern the activity subject of the EU ETS scheme [341, 342, 343]. However, the Commission services are of the opinion that the Czech
authorities have not proved that statement as they did not look closely at the green-house gas (GHG) certificate content issued at national level and did not analyse its' boundaries.

The applicant did not respect the call n° II formal requirement ('to submit information on:

• energy efficiency improvement measures supported under the project and its relation to the main production system among the Annex I activities;

• the amount of allowances under the EU ETS scheme to be reported on an annual basis;

• the quantity of emissions reported and impact of project implementation on its level'),

nor did the managing authority check if this formal requirement was respected and analysed its impact at evaluation of the application stage. See criterion nr 13 in Annex-3 Evaluation and selection criteria page 3.

Moreover, as this information was not provided by the applicant in the application for the co-financing, which according to the call rules shall include a description, whether the project activities were not concerned by the activities included in the Annex I of the Directive 2003/87/EC, the Commission services consider that the eligibility of the project application was not carried out in line with the requirements of the call for proposals. In addition, the Commission auditors reiterate that the scope of the project was not assessed against the scope of the GHG emission certificate issued at national level and the managing authority in this respect has not drawn the conclusions.

In the reply to the draft audit report, it is stated that the application concerns only a boiler room and the combustion of fuels using the relevant boilers. REGIO auditors note that the application (page 4) states that ‘...the investments are planned for the process of hydrolysis, parks and distillation. However, the streamlining of technology processes will make it possible to reduce the use of current sources of heat and, in the future, also allow potential and economically sustainable change of the heat source to greener option’. This means that the results of the project have an impact on activity subject of the EU ETS scheme included in Annex I of the Directive 2003/87/EC. They do concern combustion plant and its boundaries [345] according to the Commission services assessment. They should therefore, be financed solely by the allowance available under the EU ETS scheme for Ethanol Energy a.s. and not by the ERDF.

The Commission also disagrees with the statement included in the reply [345] that ‘there is no direct reduction in their GHG emissions either within the meaning of the guidance document received from REGIO, or pursuant to Regulation No 1301/2013’. This element, as underlined above, should be declared in the application by the beneficiary and checked by the managing authority against the GHG emissions certificate issued at national level. This had not been performed.

Moreover, the statement of the Czech authorities goes against the project application content and the main purpose of the call n° II that was to demonstrate climate and energy benefits (See criterion 2 part C of the Annex 3 of the call Energy Savings) through achieving a significant level of CO₂ reduction. During the evaluation, the application of the Ethanol Energy a.s. was scored with 32 points (maximum out of 100). Therefore, it cannot be concluded that there was no direct reduction of GHG emissions as a result of the measures supported under this operation, as it was the main purpose of this call and the project itself. The applicant declared that ‘the project purpose is to reduce energy intensity of the ethanol production processes of Ethanol Energy a.s. Vrda. Energy savings will be achieved by replacing, complementing and modifying technological processes and technology in
manufacturing for hydrolysis, distillation and debarks of furate. This will make the production process more efficient, thereby reducing the energy intensity of production by up to 37% and generating savings up to 283 222 GJ and 23293 t/CO2 per year’ (Application for support, Purpose of the project - p.1). On that basis it cannot be concluded by the managing authority [345, 346, 347] that the greenhouse gas emissions are reduced indirectly because the example indicated in the reply is not relevant in the case of the beneficiary. Its own heat distribution network serving its main production cannot be dissociated from the boiler (the heat source) for the purpose of eligibility of expenditure and respect of Article 3(3)b of the Regulation 1301/2013.

The guidance provided by REGIO cannot be used as a basis for splitting the activities of the same operator recorded under the EU ETS scheme, because this operator is listed in the ETS register precisely due to the heat sources that are directly linked with its production installation including heat distribution system. Any change in this installation may affect the GHG emission certificate content and should be adequately reported and reflected in this certificate. Consequently this change should be analysed each time by the managing authority in the application for co-financing due to the principal legal requirement stemming from Article 3(3)b of the Regulation 1301/2013.

It is worth noting that the statement of the managing authority that ‘the activity of combustion of fuels is not covered by the support...’ [346] is contradictory to its own statement provided earlier in the reply that: ‘...the application concerns only a boiler room and combustion of fuels using the relevant boilers.’ [342]. REGIO auditors consider that the investment under the project relates to the beneficiary’s own source of energy, which cannot be dissociated from its installation as Ethanol Energy a.s. is its sole operator. Therefore, it concerns the same activity. In addition, this is why this installation as a whole was registered under the EU ETS scheme and therefore why the project cannot be eligible for ERDF funding.

Concerning the information provided by the managing authority that the assessment of the issue by an internal evaluator had been dealt with by the relevant unit of the MA for about a year and a half earlier, the Commission services would like to underline that the guidance provided by REGIO (Annex 35 to the reply from the Member State to the draft audit report) required that ‘... the managing authority needs to perform an assessment for each individual project application. There is no one-method-fits-all which could be applied to all projects of similar nature.’ This aspect was correctly addressed when preparing the call no. II documentation, but not during the submission of the particular application by Ethanol Energy a.s. or with a due diligence by the managing authority during the evaluation process.

REGIO auditors note the explanations of the managing authority regarding operation no. CZ.01.1.02/0.0/0.0/17_109/0011122 (beneficiary Lovochemie a.s.) that the production of a mix for manufacturing of sulphur fertilisers does not fall under the activities covered by the EU ETS scheme and that it does not have any direct impact on installations or activities covered by the EU ETS scheme. However, REGIO auditors disagree with this statement.

According to the application from the beneficiary, among the expected results of the project implementation are: ‘electricity cost savings and significant reduction of emissions from the production of DASA (brand name of the fertiliser) – NOx, dust, NH3’ (See the application for funding p. 4). Therefore, the application of the beneficiary should be assessed against the scope of the GHG emission certificate issued for its installation in order to allow the company to benefit from the allowances under the EU ETS scheme and ERDF at the same time, if no double funding was identified.

Although the managing authority stated that ‘the project is independent of the scheme and comprises only a shift of production from one place to another’, the relevant individual
assessment of the application against the scope of the GHG emission certificate and potential impact of the project results on it, had not been performed. No other evidence has been provided to the Commission services by the managing authority to support its statements. However, REGIO auditors consider that the beneficiary itself, in its application, has highlighted the impact on GHG emissions reduction and considered it as significant (See the application for funding p. 4).

In addition, in the reply the Czech authorities underline that ‘the project will result in an increased consumption of steam and other inputs of this production’. REGIO auditors understand that this will result in increased energy consumption and will have a direct impact on the total volume of emissions produced by Lovochemie a.s. which nevertheless has also not been assessed by the managing authority.

REGIO auditors reiterate that reduction of GHG shall not be a direct effect of the operation support and shall not increase the output capacity of the facility supported when the EU ETS scheme operator applies for ERDF support.

In view of the above, both operations are considered ineligible.

The recommendation 18a is therefore maintained and remains open.

The managing authority is requested to correct the ineligible expenditure and to cancel the public contribution to the operations Ethanol Energy a.s. (CZ.01.3.1.0/0.0/0.0/16_061/0011011) and Lovochemie a.s. (CZ.01.1.02/0.0/0.0/17_109/0011122) and to report accordingly to the Commission.

Finding 18b is maintained.

The managing authority provided a table with the results of the verifications of all other operations under the EU ETS scheme to ensure that there is no double financing. However, this analysis did not take into account the content of the related GHG emission certificate issued for each beneficiary at national level. No evidence of such an assessment has been provided. On that basis, it is impossible to confirm to what extent the actual investment planned by the project application is separable from the EU ETS scheme installation.

REGIO auditors would like to highlight the importance of ensuring a level playing field when the managing authority verifies operation. Taking into account that the different set up in installations producing the same product may result in considerable differences regarding the eligibility for funding:

- If the installation imports heat, it is not under the EU ETS scheme. For example, producing ethanol is not an Annex I activity and therefore it is eligible for the ERDF funding
- If the installation has its own heat production, but it has a rated thermal input of less than 20MW it is not under the EU ETS scheme and it is therefore eligible for ERDF funding
- If the installation has its own boiler with a rated thermal input above 20MW it is covered by the EU ETS scheme and it is therefore not eligible for ERDF funding.

The recommendation 18b therefore remains open.

The managing authority is requested to:

- Re-examine the applications submitted by the operators registered under the EU ETS scheme against the content of the related GHG emission certificates
• Ensure that there is no double financing in case of the ERDF beneficiaries also benefiting from allowances under the EU ETS scheme.

Importance: Critical

Body responsible: Managing authority of the OP EIC

Deadline for implementation: 2 months
Finding 19

Ineligible operation 2014-2020 - Project no CZ.01.1.02/0.0/0.0/17_109/0011122 (beneficiary Lovochemie a.s.)

Category: KR2

Contrary to the obligation set out in the Evaluation Model for Call IV ‘Innovation’, the evaluators do not sufficiently ‘justify in their own words’ [sic] the amount of points allocated but limit their comments to either repeating/paraphrasing the text contained in the project application. In some cases, the evaluators refer to a specific document, which however, does not justify the amount of points allocated or provide a general statement referring to ‘documents provided by the applicant’ which hinders the re-performance of the evaluation process.

REGIO auditors identified the following errors in the evaluation process, which had an impact on the amount of points attributed to the applicant:

- For criterion B.1 (‘Technology transfers taking place in the last 3 years in the form of exploitation of intellectual property rights (invention/patent, industrial or utility model)’, the evaluator no 2826 gave 2 out of the maximum 2 points and justified this point allocation by a general statement saying that ‘the applicant proved the technology transfer (patent, know-how) by supplying the necessary documents’ but fails to identify the specific document based on which he reached his conclusion. For the same criterion, the evaluator no. 4252 allocated 1 out of 2 points and justified this points allocation by stating that ‘the applicant carried out 1 relevant technology transfer in the form of transfer of patent for granular fertilizer (Dusikaté sirné granulové hnojivo a jeho příprava) from VUCHT a.s. to the applicant.’

However, this agreement does not qualify as an agreement demonstrating the transfer of intellectual property rights to a patent because the subject matter of the agreement was not protected by a patent and as such cannot serve as a justification for the points allocation.

Moreover, even if a transfer of intellectual property rights took place between VUCHT and the applicant, such a transfer should be considered as an internal transfer within the same group as both companies are part of AGROFERT group.

- Both evaluators (no. 4252 and no. 2826) gave 4 points out of the maximum 4 points for criterion B.2 ‘Cooperation with public research institutions or universities in the area of research and development activities in the last 5 years’. The requirement for such a points allocation is the existence of a long-term contract for joint research. In order to justify the 4 points, the evaluator no. 4252 refers to a long-term cooperation of the applicant with UJV Řez, a.s. (a commercial company outside of the AGROFERT group). Given the fact that UJV Řez is not a public research institution nor a university, such cooperation cannot serve as a justification for allocating the 4 points by evaluator no. 4252. The second evaluator justified the points allocated only by stating that ‘the applicant supplied relevant documents demonstrating a cooperation with universities and public research institutions’ but did not refer to a specific agreement which in his opinion fulfils the set requirements.

- For criterion B6 „Own research and development department or innovation strategy of the company”, both evaluators gave 2 out of the maximum 2 points and justified their allocation by referring to applicants „research and innovation department which creates his research and development strategy”. In addition, the evaluator no. 4252
states that the existence of this department is proved by the organisational structure of the applicant. REGIO auditors detected in this context that the applicant does not have a research and development department. On the contrary, the applicant’s annual reports explicitly states that ‘the department of technical development was cancelled in 2012 and the research activities are dealt with centrally by Agrofert a.s.’ As the applicant does not have a research and development department and does not describe its innovation strategy, the allocation of points cannot be considered justified.

- In the case of criterion C3 for which both evaluators allocated 4 points corresponding to Level 5 product innovation on the Valenta scale, the evaluators only repeat/rephrase statements provided by the applicant in its business plan / feasibility study without providing their own independent assessment of why a specific number of points was allocated. In this context, REGIO auditors assessed the product innovation described by the applicant and came to the conclusion that it does not reach Level 5 innovation on the Valenta scale. The result of the product innovation described by the applicant does not lead to a new variant of the product which would represent a change in one or more of its functions but is merely a qualitative adaptation of a product already produced by the applicant and his competitor and as such corresponds only to Level 4 innovation on the Valenta scale. Thus, no points should have been allocated for this criterion.

Despite the errors in the evaluation described above and insufficient justification provided by the evaluators, the selection committee recommended the project for financing without requesting the evaluators to comply with their obligation set out in the Evaluation Model. Given the fact the project was not evaluated in line with the Evaluation Model, it should not have been recommended for financing by the selection committee and as a consequence is not considered eligible for financing.

**Action to be taken / recommendation**

a) The managing authority is requested to correct the ineligible expenditure already declared for this operation and to cancel the public contribution to it.

b) The managing authority is requested to ensure that the evaluation process provides robust evidence to demonstrate full compliance of grant applications with the selection criteria. Operations for which insufficient evidence of compliance is provided in the application should be set aside and a request for further information sent to the applicant. If ultimately they are not in line with the selection criteria they should be rejected.

c) The managing authority is requested to confirm that the selection criteria were appropriately applied for all remaining operations linked to the AGROFERT group and to apply the necessary additional corrections if needed.

**Importance:** Critical

**Body responsible:** Managing authority of the OP EIC

**Deadline for implementation:** 2 months

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**Position of the Member State:**

*Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.*

Criterion B.1 Technology transfer
[353] The audit questions the points awarded and their justification on the part of both internal evaluators. Internal evaluator 2826 accepted two transfers - a patent (from VÚCHT) and one transfer involving know-how (from the Inorganic Chemistry Institute of the Czech Academy of Sciences), and awarded two points. Internal evaluator 4252 accepted one transfer (a patent from VÚCHT) and awarded one point. References to documents using general indications are entirely sufficient as the annexes to the project application will guide anyone directly to the documents concerned. As regards the transfer of rights to a patent from the patent's co-holders, namely employees of VÚCHT, we consider its acceptance as a transfer to be fully justified. If an internal transfer within the same group was involved, the contract specified in the annex to the project application would have to contain a reference to an internal mile applicable horizontally within the group.

Criterion B.2: Cooperation with public research institutions or universities in the area of research and development activities in the last five years.

[354] The audit notes that both internal evaluators awarded the maximum number of points, i.e. four points, which corresponds to the existence of a long-term contract for joint research; internal evaluator 4252 justified the award of maximum points with the cooperation with ÚJ Inst. Réž (a contract with the company is given in the annex), while internal evaluator 2826 only notes that the applicant had supplied relevant documents. In the first case, it is true that ÚJ Inst. Réž, despite the fact that its research and development activities are generally well known even outside Central Europe, is not a public research organisation found on the list drawn up by the competent authorities. In the case of internal evaluator 2826, we believe that a simple reference to the existence of documents proving cooperation is sufficient. Similarly to criterion B. 1, it also applies here that the annexes to the project application will guide anyone assessing the fulfilment of this criterion clearly to the documents concerned. The criterion is fulfilled by cooperation with VŠCHT, which has been demonstrated.

Criterion B.6: Own research and development department or innovation strategy of the company

[355] As for the Commission auditors' claim that the applicant does not have a research and development department, this is true only to the extent that there is no department with such a name within the applicant's organisational structure. In its Business Plan, the applicant states that at Lovochemie a.s. research and development activities are carried out by the Quality Management Unit (Oddeleni řízení jakosti), within which there are central laboratories. When deciding whether the actual situation in a company as regards its research and development activities can be viewed as if the research and development activities have been concentrated within one organisational entity, or as if research and development activities have been incorporated into the tasks of individual employees, or even as if there is a department dealing with designs within the company, in this particular applicant's case the arguments in favour of the existence of a separate department prevail. Even if it does not form part of the project application, the company's organisational structure as it is presented on the company's website supports such a conclusion.

Criterion C.3: What is the product innovation ranking on the Valenta scale? (will be evaluated only if the product innovation activity is implemented)

[356] When assessing the accuracy of the opinions of both internal evaluators, the auditors claim that the internal evaluators merely repeated the information provided by the applicant in the project application; the auditors express their concerns as to whether the innovation at issue might only constitute a qualitative adaptation constituting a Ranking 4 innovation.
[357] As regards the justification given by the internal evaluators in their evaluation, it needs to be pointed out that the justification is not contained merely in the criteria table, but also in the summary evaluation of the project. In this form it fully complies with the evaluation standards. The fact that the information used was the information provided by the applicant in the project application merely means that that information is not being contested and is regarded as relevant for the evaluation. Projects are assessed by independent evaluators, who might take different views on the issues at question. Quoting text from the applicant's Business Plan cannot be considered an error. Where an evaluator deems an evaluation criterion fulfilled and in his comments repeats the text written by the applicant, it could, from the evaluator's point of view, be a way of saving time for his own linguistic expression, in terms of style, rather than being an insufficient assessment of the application material.

[358] As to the comment whether the product might correspond merely to Ranking 4 innovation, we can only point out that the internal evaluators accepted the applicant's proposal as indisputable, even though in this case it might have been relevant to ask the question whether the changes in the product might perhaps be closer to Ranking 6 innovation instead.

[359] Following an explanation and disagreement already expressed in respect of the preliminary audit opinions on this project, the following conclusion can be made. Both internal evaluators acted within the framework foreseen for substantive evaluation in the Operational Manual of the Operational Programme ‘Entrepreneurship and Innovation for Competitiveness’. In the light of the above, we cannot agree with the auditors’ findings and recommendations concerned. Even if the scoring were lowered (by one point in total), the project would still fulfil the selection criteria and would be recommended for support. Nothing would change in the subsequent steps in the project's life-cycle.

Based on the above facts we disagree with the audit findings and request that they be amended or removed.

**Conclusion of the Commission services:**

The finding is **maintained** and further clarified as follows.

The Commission services have analysed the Member State's reply and maintain their position that the project was not evaluated in line with the Evaluation Model, should not have been recommended for financing by the selection committee and, as a consequence, is not considered eligible for financing. The analysis of the Member State’s reply and additional argumentation supporting this conclusion are set out below.

In this regard, and to address concerns raised in the Member State’s reply in respect of the auditors' competence in this technical area, the Commission services contracted two highly experienced external experts to re-perform the evaluation, including an evaluation under the Horizon 2020 approach mentioned in the Member State’s reply. One of these experts has a Doctorate degree in Technical Disciplines, is an associate university professor, has experience as a senior expert for the Commission and the European Parliament, over 20 years experience including 6 years of proposal assessment for the Commission Framework Programmes and is an expert in the fields of energy and the environment and methodology, research and development, innovation and impact assessment. The second expert has an MA in Applied social sciences, is an independent consultant in the areas of evaluation, agriculture, food, environment with more than 15 years experience (full EU coverage and selected non-EU countries), has worked in the public, academic and private sectors (both SMEs and corporate), has a strong background in evaluation methodologies, innovation and technology assessments and is an experienced evaluator and proposal developer for various funds, (e.g. European

Their conclusions confirm the Commission services position that the project should not have been selected. Their assessments are incorporated in the analysis below.

**Criterion B.1 Technology transfer**

The beneficiary submitted two documents with its application in relation to fulfilment of criterion B.1 (‘Delivered technology transfers in the last 3 years in the form of exploitation of industrial property rights’).

The first relates to a license agreement with UACH (Ustav Anaorganicke Chemie) concluded in March 2005. As this is a 2005 agreement, it does not meet the requirement of having been concluded ‘in the last 3 years’, and therefore does not satisfy criterion B.1.

The second document is an agreement between Lovochemie a.s. and VUCHT a.s. of March 2017 which led, in the opinion of evaluator 4252, to the transfer of a patent for granular fertiliser. As stated in the draft audit report, the agreement with VUCHT a.s. does not fulfill criterion B.1 as a patent had not actually been granted at the time of signature of this contract.

In this regard, reference is made to Annex D of the Call for applications (Evaluation model and criteria for evaluation and project selection) which states that in case of entities other than universities and research institutes:

> the transfer of technology is understood as a transfer of only such solutions that are protected by industrial property rights (patents/inventions, industrial or utility designs) in a form of direct purchase of the intellectual property right or purchase of a license for its exploitation.

Therefore, as Criterion B.1 was not fulfilled, no points should have been awarded under this criterion (instead of the 2 points awarded by evaluator 2826 and one point awarded by evaluator 4252). The two independent external experts contracted by the Commission services both scored this criterion with 0 points.

**Criterion B.2: Cooperation with public research institutions or universities in the area of research and development activities in the last five years**

Criterion B.2 relates to cooperation with public research institutes and/or universities in the field of research and development in the last 5 years’. The requirement was to submit evidence in this regard.

The Member State’s reply states that ‘a simple reference to the existence of documents proving cooperation is sufficient’.

The Commission services disagree with this statement. The applicant did not refer in the Business Plan or in the annexed files to specific agreements made with public research institutes and/or universities. Indeed, the actual agreements listed in the annexes include agreements that are clearly not compliant with Criterion B.2. Therefore, a simple reference to the existence of documents proving cooperation is not considered to be sufficient.

As acknowledged in the Member State’s reply, ÚJV Řež is not a public research organisation. Therefore, co-operation with this entity does not fulfil Criterion B.2.
The agreement with VŠCHT is a service contract and not an agreement to cooperate in research and development activities. Therefore, the service contract with this entity does not fulfil Criterion B.2.

As no evidence of fulfilment of Criterion B.2 has been provided, no points should have been awarded under this criterion (instead of the 4 points awarded by both evaluators 2826 and 4252). However, as the two independent external experts contracted by the Commission services scored this criterion with 4 and 2 points respectively, REGIO auditors do not further question the original scoring under this criterion.

**Criterion B.6: Own research and development department or innovation strategy of the company**

In the Annual Reports of Lovochemie a.s. it is clearly stated that the R&D Department in Lovochemie a.s. was closed in February 2012, (i.e. before submission of the project application).

In addition, the tasks and duties of Quality Management Unit, referred to in the Member State’s reply, are inherently different to those of a Research and Development Department. The applicant did not provide any relevant document demonstrating that the Quality Management Unit carries out any research and development activities.

Therefore, as there is no evidence that Criterion B.6 was fulfilled, there is no justification for the 2 points awarded by both evaluators. However, as the two independent external experts contracted by the Commission services scored this criterion with 2 points and 0 points respectively, REGIO auditors do not further question the original scoring under this criterion.

**Criterion C.3: Product innovation ranking on the Valenta scale**

The Commission services would like to clarify that the failure of the evaluators to follow the obligation set out in the Evaluation Model to ‘justify in their own words’ [sic] the amount of points allocated is not the only factor in considering the ineligibility of this operation.

Concerning the ‘product innovation’ aspect according to Valenta scale, the Commission services maintain that the new product represents only Level 4 of innovation, (i.e. ‘Qualitative adaptation, involving qualitative adaptation of the element subject to innovation to the quality, but also quantity parameters of other elements of a business unit’).

In the context of this project, this ‘qualitative adaptation’ includes adapting the shape of the components of a future product to the technical parameters of the machine on which they are produced, increasing the manufacturability of a design. This is due to the main change related to the lower shore viscosity and the more compact and homogeneous granules that improve storability of the new product.

In this regard, the applicant has not proven that the new product would have a significantly improved impact on plants as a fertiliser. Therefore, substantial product innovation has not been demonstrated. The result of the product innovation described by the applicant does not lead to a new variant of the product that represents a change in one or more of its functions but is merely a qualitative adaptation of a product already produced by the applicant and its competitor.

Therefore, the project only delivers innovation of Level 4 innovation on the Valenta scale and should not have received any points under this criterion (instead of the 4 points actually awarded). The two independent external experts contracted by the Commission services both scored this criterion with 0 points.
Other elements relevant to the evaluation demonstrating that the project should not have been selected.

The two independent expert re-evaluations carried out on behalf of the Commission services scored the evaluation as follows (the original evaluation is also included).

**Table: Re-evaluations carried out on behalf of the Commission**

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Maximum points</th>
<th>National evaluation</th>
<th>EC independent expert evaluator 1</th>
<th>EC independent expert evaluator 2</th>
<th>Higher of Ev 1 &amp; Ev 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>B.1</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>B.2</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>B.3</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>B.4</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>B.5</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>B.6</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Total B</td>
<td><strong>15</strong></td>
<td><strong>12</strong></td>
<td><strong>11</strong></td>
<td><strong>8</strong></td>
<td><strong>8</strong></td>
</tr>
</tbody>
</table>

| C.1 | 7 | 3 | 3 | 1 | 1 | 1 |
| C.2 | 12 | 6 | 6 | 4 | 4 | 4 |
| C.3 | 12 | 4 | 4 | 0 | 0 | 0 |
| C.4 | 9 | 5 | 3 | 1 | 5 | 5 |
| C.5 | 10 | 6 | 5 | 3 | 5 | 5 |
| C.6 | 8 | 8 | 8 | 8 | 0 | 8 |
| C.7 | 2 | 2 | 2 | 0 | 1 | 1 |
| C.8 | 2 | 2 | 2 | 0 | 0 | 0 |
| C.9 | 6 | 6 | 6 | 6 | 3 | 6 |
| Total C | **68** | **42** | **39** | **23** | **19** | **30** |

| D. Specific criteria | 5 | 5 | 5 | 5 | 5 |
| E. Budgetary management | **12** | **12** | **12** | **12** | **12** |

| Total (Minimum required = 60) | **100** | **71** | **67** | **48** | **40** | **55** |

Where the scores awarded by the two external evaluators differed, taking the more favourable scores under each affected criterion results in a revised maximum score of 55, which is still below the minimum selection threshold of 60.

The main sub-criteria where the independent expert re-evaluations differ from those of the original evaluators (i.e. beyond the criteria already mentioned above namely B1, B2, B6 and C3) are:

- **B3** Co-operation with other R&D firms over the last 3 years
The submitted documents do not confirm any long-term research cooperation (more than 5 years) with R&D firms. One contract with Karlovopolska RIA 2013 does refer to final testing. The other contracts submitted are only service contracts and not related to R&D. Therefore, 1 point can be given under this criterion which is fulfilled at the level of ‘At least one contract’ (instead of the 3 points awarded by each of the original evaluators).

- **C.1 Market and sales potential**

Since there is existing competition regarding the product and the process (the applicants stated that similar reactors are already in use), the outcome of the project cannot be qualified as a ‘new/innovative product or process leading to the opening of new markets’.

In addition, as the new product / process cannot be qualified as an ‘environmentally friendly product or process’ (see further explanation regarding environmental impact under criterion C.7), the project proposal only fulfills the category of ‘Passive response to the market’ and therefore should have received only 1 point (instead of the 3 points from both original evaluators). The two independent external experts contracted by the Commission services both scored this criterion with 1 point (instead of the 3 points awarded by each of the original evaluators).

- **C.2 Novelty of the process for innovation orders under Valenta**

Regarding the ‘process innovation’, according to Valenta scale, the new process represents Level 5 of innovation (i.e. ‘New variant representing a change in one or several functions of an element of a business unit subject to innovation’). The new process is based on the new reactor. However, this reactor is of a similar type to reactors used for the production of ammonium nitrate, as stated in the proposal Business Plan (Section 3.1. ‘Specification of the subject matter of the project - basic characteristics’). According to the applicants, the construction concept is maintained but the construction solution is changed and there is a transition from a vacuum system to a pressure relief system. In practice, this means ‘a change of one or several functions’, particularly as similar type reactors are already in use. Therefore, the project delivers innovation of the 5th order equating to 4 points, as indicated by both of the Commission’s external experts (instead of the 6 points awarded by each of the original evaluators).

- **C.4 Degree of novelty of the resulting process in relation to the market**

According to the applicant, the new process is based on a new reactor. However, it is of a similar type to reactors used for the production of ammonium nitrate, as stated in the submitted Business Plan (3.1. ‘Specification of the subject matter of the project - basic characteristics’). The use of the new reactor is only innovative at the company level. Therefore, the degree of novelty can only be assessed as ‘new for the business’ and the proposal should have received 1 point (instead of the 5 points and 4 points given by the two original evaluators). However, as the external evaluator 2 contracted by the Commission services scored this criterion with 5 points, this more favourable assessment is taken into account.

- **C.5 The degree of novelty of the product**
The applicants declared that the ‘output product, an innovative DASA fertiliser, will have similar characteristics to those of competitors’, including the competitors present on the market in the Czech Republic. Therefore, the degree of novelty of the resultant product should be assessed as ‘new for the business’ and the proposal should have received 3 points (instead of the 6 points and 5 points given by the two original evaluators). However, as the external evaluator 2 contracted by the Commission services scored this criterion with 5 points, this more favourable assessment is taken into account by REGIO auditors.

C.7 A positive or neutral effect on the environment

It cannot be concluded from the application that the project would have a positive or neutral impact on the environment as:

i. While the applicant claims a ‘significant impact on enhancing the purity of the environment’ and support this opinion with data (Table 22 of the application – ‘Comparison of the statutory limits with the emission values of the technology’), in reality, even though the emissions from the process itself remain within the legal limits, their total value may increase. This is related to the significantly increased use of NH3 (from 8,5 kg to 143,6 kg for DASA 26 + 13S and from 60 kg to 114 kg for DASA 25 + 12S – see Table 11).

ii. Even though the emissions from the process carried out in the new type of reactor are reduced, the overall emissions level must include the whole Life Cycle Assessment, from raw materials, through to the production of ammonia, sulphuric acid and all other ingredients, their transportation to the production site, the fertiliser production process, transportation of the finished product to the end-user, the product application in agriculture (or other relevant sectors) as well as all other stages of the life cycle until the end of life. As a LCA report was not submitted, there is no evidence that the environmental impact of the product and processes were fully checked. Therefore, the positive or neutral environmental impact cannot be confirmed. Consequently, this criterion should be assessed as ‘the project does not consider environmental protection as one of the main (integral) objectives of the project’ and the proposal should have received 0 points (instead of the 2 points from both original evaluators). However, as the external evaluator 2 contracted by the Commission services scored this criterion with 1 point, this more favourable assessment is taken into account by REGIO auditors.

C.8 Energy and material performance of the production

In spite of the applicant’s statement that the project will contribute to the reduction of electricity consumption, the project does not contribute to reducing the energy and material intensity of production. This can be explained by the following:

i. In Table 11 of the Feasibility study for the new production data, compared to the existing production of DASA 26 + 13S, an increased electricity consumption can be seen (from 57 kWh to 90 kWh)
ii. In Table 11 of the Feasibility study for the new production data, compared to the existing production of DASA 25 + 12S, a reduction in terms of electricity consumption can be seen (from 98 kWh to 90 kWh). This is less than 10% and cannot be regarded as a significant reduction in terms of energy consumption as claimed by the applicant in part 5.3 where it is stated that “The presented project significantly reduces the energy and material intensity of the production (see Table 11- Production parameters of the product).

iii. The data mentioned above is given in kWh and it is not clear if the value is calculated per year. The correctly identified value should be given in kWh/year (or GWh/year) to enable the assessment of the energy consumption to be made for the relevant period.

iv. Raw material consumption can be slightly reduced in case of Dolomite (from 36 kg to 29,9 kg) but the full information about the Life Cycle Assessment of this material was not provided and therefore the real value of this potential reduction is not sufficiently justified.

Therefore, this criterion should have received 0 points, as assessed by both of the Commission’s external experts (instead of the 2 points given by both of the original evaluators).

The results of evaluations carried out by the two independent external contracted by the Commission services clearly demonstrate that the project should not have been selected as the both evaluators gave a total score that was significantly below the minimum threshold of 60 points required in the call. Indeed, even if the higher score of both external experts under each sub-criterion is used by the Commission services, the total points would be 55, again below the 60 points threshold needed for selection.

Finally, a separate section of the Member State’s reply states that the evaluation criteria under the Enterprise and Innovation OP are more precise and more stringent than under the Horizon 2020 (H2020) programme, managed directly by the Commission, REGIO therefore requested one of the independent external evaluators contracted by the Commission services to evaluate the projects using the H2020 approach. The external evaluator gave the project a score of 3 out of 15 points, with the threshold for selection for funding under the programme being greater than or equal to 10 points. This provides evidence that in the Commission services’ view, the project should also not have been selected under H2020.

Admissibility of the project

(a) Section 9.1.k of the Programme Specific Terms and Conditions

Section 9.1 of the Programme Specific Terms and Conditions for priority axis A1 of the Enterprise and Innovation OP 2014/2020, containing the formal conditions for the admissibility of projects, sets out at subsection k, that projects whose outputs are expected to be, inter alia, in the agriculture, forestry, fisheries or aquaculture sectors (CZ-NACE A 01, A 02, A 03) are not eligible.
In this regard, Part 3.6 of the applicant’s Business Plan which deals with the ‘Compatibility of the project with the National Research and Innovation Strategy for Smart Specialisation of the Czech Republic (‘National RIS3 Strategy’)’ states clearly that:

The applicant will contribute with this project to the National RIS3 strategy of the Czech Republic. The outcome of the project falls under the National Specialisation Domain, priority application domain 1.6.2. Sustainable agriculture and forestry. (emphasis added)

The purpose of the project matches this domain. The starting point of sustainable agriculture and forestry development, is improving efficiency, productivity and as a consequence the competitiveness of agricultural and forestry products. Ensuring sustainable (environmentally friendly) agricultural and forestry production depends on stabilising and improving the quality of the basic production element — the soil and on securing the strategic level of production of the main agricultural commodities.

The link to the relevant domain of Advanced Manufacturing Technologies is also fulfilled; the strength of the link is identified as ‘direct’.

The Commission services therefore conclude that the project did not meet the admissibility criterion under Section 9.1.k of the Programme Specific Terms and Conditions and therefore should not have been evaluated.

(b) Criterion A.1 - The content of the project, its objective, technical implementation and eligible expenditure must be in line with the main parameters of the programme and the challenges.

The content of the project, its objective, technical implementation and expenditure are not in line with the main parameters of the programme and the challenges. The outputs of the project relate to economic activities that are excluded from support under this call.

(c) Criterion A.5 - Positive or neutral impact on the environment

It has not been demonstrated that this criterion has been fulfilled for this project. (See also comments under C.7)

Therefore, it cannot be confirmed that the project has a positive or neutral environmental impact and that the admissibility criterion A.5 was fulfilled.

Conclusion

For the abovementioned reasons relating both to the admissibility criteria and the selection criteria, the Commission services maintain that the project was not evaluated in line with the Evaluation Model, should not have been recommended for financing by the selection committee and, as a consequence, is not considered eligible for financing.

Action to be taken/recommendation

Recommendation

a) The managing authority is requested to correct the ineligible expenditure already declared for this operation and to cancel the public contribution to it.

b) The managing authority is requested to ensure that the evaluation process provides robust evidence to demonstrate full compliance of grant applications with the selection criteria. Operations for which insufficient evidence of compliance is provided in the application should be set aside and a request for further information sent to the applicant. If ultimately they are not in line with the selection criteria they should be rejected.
c) The managing authority is requested to confirm that the selection criteria were appropriately applied for all remaining operations linked to the AGROFERT group and to apply the necessary additional financial corrections if needed.

Importance: Critical

Body responsible: Managing authority of the OP EIC

Deadline for implementation: 2 months
5.2.4. Enterprise and Innovation OP (CCI 2007/CZ161PO004) 2007 - 2013

Finding 20

Ineligible operation - Project no IN04/644 (beneficiary Lovochemie a.s.)

The operation IN04/644 (Complex process innovation) aimed at innovation of the production process for nitrogen compounds, namely the improvement of the production process of calcium nitrate (process innovation) and quality improvements of two variants of this product. The project outcome presented in the grant application is:

- Process innovation (improvement of the production process of calcium nitrate)
- Product innovation (quality improvement of Agri Grade (AG) and Greenhouse Grade (GG) variant of calcium nitrate)

The beneficiary of the project, Lovochemie, a.s. is a subsidiary of Agrofert, a.s., a parent company of the AGROFERT group.

In accordance with the Call for projects no IV Innovations – only operations with direct links to Research & Development activities (i.e. they use the results of their own Research & Development, the Research & Development results created in cooperation or the transfers of technology) can be supported.

Part 1 (Exclusion selection criteria) of the selection criteria stipulated in point 2 'Link of the project to Research & Development activities' that:

- the development has been completed;
- the project uses the results of own Research & Development, the Research & Development results created in cooperation or the transfers of technology;
- in case of own Research & Development or the Research & Development results created during the cooperation, the applicant must prove the existence of the functional prototype or the sample;
- in the case of the transfer of technology the applicant must prove the existence of the functional prototype or the sample and this transfer must be supported by a contract.'

In reply to this exclusion criterion, the applicant states that the project relies on the results of research and development activities of VUCHT, a.s. (a company belonging to the AGROFERT Group). The research results of VUCHT led to a patented method of preparation of granulated water-soluble calcium-nitrogen fertilizer (patent no. 287816, which contains a detailed description of the production process of calcium nitrate). This patent is owned by company Duslo, a.s. (a company belonging to the AGROFERT Group).

In order to demonstrate the existence of a functional prototype and product samples, the applicant stated that company Hnojivá Duslo s.r.o. (another company belonging to the AGROFERT Group) possessed a functional production line and samples because the company is already producing these products.

Given the fact, that another company in the AGROFERT Group already possessed the production line which was subject of the innovation described in the project application (process innovation) and was already producing the products subject of the innovation described in the project application (product innovation), REGIO auditors take the view that the project does not introduce any innovation supported by the existence of a prototype or a sample. Therefore the binary selection criteria were not met and the project application should have been excluded from further evaluation as ineligible.
Moreover, the Commission services identified the following observations, which undermine the transparency, equal treatment and the fairness of the selection procedure of the project in question:

**Insufficient audit trail related to external evaluators selected for the substantive evaluation of a project**

For the preparation of the REGIO’s audit, the Czech authorities provided two evaluation sheets prepared by external evaluators selected for substantive evaluation of a project application. Both of these external evaluators recommended the project for financing. One evaluator allocated 45 points and the other 46 points out of 81 (the minimum amount of points necessary for approving the project was 45 points).

During the audit, the auditors received a list of external evaluators selected for evaluating project applications submitted in reply to the Call in question. This list mentions that three external evaluators were actually used for evaluating this operation. In contradiction to the documents provided before the mission and the information contained on the list of external evaluators, REGIO auditors found four evaluation sheets when reviewing the project related documentation in the ISOP IT system. As only two out of these four evaluation sheets were in a format that REGIO auditors were able to open, the auditors requested the MA to provide all four listed evaluation sheets in a PDF format. Following the receipt of the PDF documents, REGIO auditors found three evaluation sheets allocating between 45 and 46 points recommending the project for financing and one evaluation sheet with 41 points and not recommending the project for financing.

While on the basis of the documents presented before the audit mission, REGIO auditors understood there were only two evaluation sheets related to this project, the list of evaluators presented during the mission mentioned three evaluators and REGIO auditors finally identified four evaluation sheets actually dealing with this project evaluation. No information was presented to REGIO auditor clarifying the discrepancy of the information provided before, during and after the mission and explaining when and why the individual evaluators were replaced and on the basis of what considerations, two out of the four evaluation sheets were selected to be taken into account when recommending the project for financing.

In this context, the managing authority is requested to explain the sequence of events, and provide clarification as to why and when the additional evaluators were invited to evaluate the project application.

**Errors in the evaluation process**

REGIO auditors identified errors in the evaluation process, which had an impact on the amount of points attributed to the applicant.

- For criterion A.2 ("Technology transfer in the last 3 years in the form of exploitation of patent or purchase/sale of license"), two out of the four evaluators allocated 2 out of 2 points, one evaluator allocated 1 point and one allocated 0 points. REGIO auditors did not identify any technology transfer either referenced in the applicant’s feasibility study or provided in any of the submitted annexes. Thus, in the REGIO auditors view, no points should have been allocated for this criterion.

- For criterion A.3 ("Cooperation with R&D institutions or universities in the last three years"), two points can be allocated when the applicant presents a long-term contract
for joint research. All four evaluators allocated 2 out of 2 points referring to a contract concluded with University of Chemistry and Technology Prague (Vysoká škola chemicko-technologická v Praze – ‘VSCHT’). REGIO auditors did not identify in the project file any contract with VSCHT which would qualify as ‘a long-term contract for joint research’ and thus in the REGIO auditors view, the two points should not have been given.

- For criterion A.8 (‘Own research and development department or innovation strategy of the company’), three evaluators allocated 2 out of maximum 2 points and one evaluator allocated 0 points. The applicant mentions in its feasibility study a ‘Department of development and quality’ but which cannot be considered a research and development department. Given the fact that the applicant does not have a research and development department and does not describe its innovation strategy, in the REGIO auditors view, no points should have been allocated for this criterion.

- For criterion B.1 (‘How is the project reacting to the market situation’), two evaluators allocated 4 points, one evaluator 3 and one evaluator 2 out of six points. While the project application introduces a product of improved quality, the applicant himself states that these products are already produced by DUSLO s.r.o. which is a company belonging to the AGROFERT Group and is listed in its consolidated annual reports. From this perspective, the applicant only extends the production which already underway at DUSLO in Slovakia to the Czech Republic. In the REGIO auditors view, one point could be considered for maintaining the market share of the applicant.

- For criterion C.1 (‘What is the novelty type of the process from the point of view of the technical solution’), three evaluators allocated 3 and one 6 out of maximum 6 points. Given the fact that the process had already been implemented by DUSLO s.r.o. which is a company belonging to the AGROFERT Group, there is no novelty introduced by the project and in the REGIO auditors view, no points should have been allocated for this criterion.

- For criterion C.2 (‘What is the novelty type of the process from the point of view of the market’). All 4 evaluators allocated 3 out of 6 points for this criterion. Given the fact that the process was already in use in DUSLO s.r.o. which is a company belonging to the AGROFERT Group, there innovation introduced by the project and in the REGIO auditors view, no points should have been allocated for this criterion.

- For criterion C.3 (‘What is the novelty type of the resulting product from the point of view of the technical solution’), Two evaluators allocated 3, one evaluator 4.5 and one 6 out of the maximum of 6 points. Given the fact that the products were already produced by DUSLO s.r.o. which is a company belonging to the AGROFERT Group, there is no product innovation introduced by the project and in the REGIO auditors view, no points should have been allocated for this criterion.

- For criterion D.1 (‘Exploitation of results of R&D in the project’), three evaluators allocated 5 and one evaluator allocated 3 out of maximum of 5 points. Given the fact
that the applicant cannot demonstrate the existence of a functioning prototype/or a
sample and on the contrary confirms that the technology based on the research of
VUCHT had been already implemented in DUSLO s.r.o., in the REGIO auditors view,
no points should have been allocated for this criterion.

Given the fact the project did not meet the binary selection criteria and also taking into
account additional errors detected in the substantive evaluation and audit trail, the REGIO
auditors take the view that the project should not have been selected for financing and is
considered ineligible.

Action to be taken / recommendation
The MA is requested to correct all related ineligible expenditure already declared under the
operational programme and to reimburse this amount to the Commission.

Importance: Critical
Managing Authority OPPI 2007-2013 – Ministry of Industry and Trade
Deadline for implementation: 2 months

Position of the Member State:
Note: the paragraph numbering below corresponds to the numbering in the reply from the
Czech authorities.

[360] When commenting on this finding, we first need to point out that the individual pieces
of information stated in the text of the Call and its annexes cannot be taken out of context.
Individually they might serve to support certain assertions, but in the context of all the other
texts and annexes their interpretation is completely different.

[361] As correctly stated by the Commission auditors, the Innovation Programme is aimed
at research and development activities - using the results of own research and development,
research and development results created in cooperation, or transfers of technology.
However, the degree of innovation of the products and the processes covered by the projects
submitted is to be evaluated - as is clear from the selection criteria that form part of the Call
and are publicly available for download here: http://old.czechinvest.org/d3ta/files/priloha-c-
2-vybuova-kriteria-2764-cz.pdf as Annex 2 to the Call - both as regards innovation from the
point of view of the applicant's company - criteria C1 and C3, and innovation from the point
of view of the market - criteria C2 and C4. If all four criteria were to be assessed in relation
to the market, it would, as regards the criteria pairs C1 and 2, and C3 and 4, be in fact a
duplicated assessment of the same aspect; nevertheless, the criteria were not set in such a
way.

[362] If only previously non-existent products and processes were to be assessed, the
absorption capacity of the programme at issue would be very limited. Even innovation only
from the point of view of a particular entity has positive effects on the whole economy,
despite the fact that the project or process put in place is not new in the Czech Republic, the
EU or worldwide. The selection criteria reflect this fact as lower-ranking innovations are
awarded fewer points in respect of the relevant criteria and, as a result, lower-quality projects
might not receive any funding.

[363] To support the above, we would point out that the selection criteria were set on the
in points 130 and 131 on page 31 the following information can clearly be found: 'The minimum entry is that the product or process, or a marketing or organisational method [translator's note: points 130 and 131 of the pdf document do not contain any reference to 'a marketing or organisational method', so the translation is not a direct quote] should be new (or significantly improved) to the firm (it does not have to be new to the world).

[364] Even if fewer points are awarded in respect of a certain criterion, the project could still be granted funding provided the overall threshold is met. Moreover, the applicant himself stated, in a transparent way, in the project description that **owing to its nature, the production process will be unique, not only within the applicant's company, but also within the Czech Republic.**

[365] The selection criteria were drawn up based on a study conducted by the Technology Centre of the Czech Academy of Sciences (TC AC ČR).

[366] Projects submitted under the Operational Programme ‘Entrepreneurship and Innovation for Competitiveness’ were evaluated by independent external parties who had to fulfill the requirement of a relevant academic background and professional experience. All evaluators concluded a framework contract with the MA of the Operational Programme ‘Entrepreneurship and Innovation for Competitiveness’ for drawing up expert opinions. Under the framework contract they undertook to refrain, under any circumstances, from contacting the entity under evaluation, to act in an impartial and objective manner when drawing up the expert opinion, and to refrain from promoting regional or other interests when drawing up the expert opinion. This is laid down in point V of the framework contract.

[367] In respect of the project at issue, a total of three technical expert opinions were drawn up (see below for a description of how they were commissioned and drawn up). Thus the technical aspects of the project were evaluated by a total of three independent experts.

[368] Evaluator A obtained a Master’s degree from the University of Chemistry and Technology in Pardubice (VŠCHT), as well as a Candidate of Sciences degree. When evaluating the project at issue, he had gained almost 30 years' experience in the given field, ranging from a standard employee to a researcher and company director.

[369] Evaluator B obtained a Master’s degree from Brno University of Technology (VUT) and a Ph.D. Degree from Tomáš Baťa University in Zlín. When evaluating the project at issue, he had gained almost 10 years' experience in the given field and a substantial publications record.

[370] Evaluator C obtained a Master’s degree of Engineer and a Candidate of Sciences degree from the Pardubice University, had had a 7 years' experience in the given field and had a substantial publications record.

[371] All evaluators received training in evaluation before the evaluation process started.

[372] No information is given as to the auditors' qualifications and professional experience in the field of chemistry and technology, or evaluation of research and development activities. We would, therefore, like to express our doubts as to whether and to what extent they are competent to evaluate the project in terms of substance.

[373] The approach taken with a view to questioning the substantive evaluation radically undermines legal certainty on the part of the beneficiary and the aid provider as practically any project might be challenged in a similar way, in particular those whose scores were close to the minimum points threshold. Selection criteria will never (and cannot) be 100% objective and there will always be scope for differences of opinion. For this reason, a minimum of two external expert opinions were always commissioned, the final scoring was calculated as an
average and mechanisms were put in place for cases where the evaluators’ opinions differed radically.

[374] As regards the actual finding claiming that the project did not meet the binary selection criteria in point 2, we would point out that all the above evaluators had the same view on this particular criterion and according to their expert opinion the project does fulfil the criteria.

[375] The MA of the Operational Programme ‘Entrepreneurship and Innovation for Competitiveness’ did not evaluate the projects itself as it makes use of external evaluators precisely because of the need for expert qualifications. Nevertheless, it provides the following comments on the above criteria.

- The criterion ‘the development has been completed’ is deemed to have been demonstrated by presenting the patent.

- The criterion regarding the results of research and development, the research and development results created in cooperation or the transfers of technology is deemed to have been met on the basis of the contracts presented.

[376] The existence of a functional prototype or a sample under the project was also demonstrated by relevant documentation.

[377] The information on who is the actual patent holder and with whom the contract was concluded is, in our opinion, irrelevant since the Call did not specify (or forbid) that it would not be possible to make use of the results of research and development or a transfer of technology within the group.

[378] It needs to be pointed out that also the evaluator who in his expert opinion did not recommend the project for funding stated that ‘Given the total scoring, the project is not recommended for funding. However, if some of the comments are taken on board, I am sure that the project would obtain the necessary score.’

[379] Moreover, it needs to be stressed that in the period 2007-2013 the Operational Programme ‘Entrepreneurship and Innovation for Competitiveness’ was subject to a number of audits, but the established project evaluation process was never challenged in such a radical way. It is, therefore, striking that it is now being questioned after seven years.

[380] As a result, the MA of the Operational Programme ‘Entrepreneurship and Innovation for Competitiveness’ does not agree with the finding labelling the operation ineligible and deems it to be irrelevant in the light of the above facts.

[381] As regards the part of the finding referring to ‘Insufficient audit trail related to external evaluators selected for the substantive evaluation of a project’, we would state the following facts.


[383] Fully in line with document 17_06_M_Metodika třídění projektů pro účely hodnocení (Methodology for classification of projects for the purposes of evaluation, forming part of the above Manual), the evaluation process took place as described below:

[384] Two technical and one economic expert opinion were commissioned, all with a deadline of 2 April 2012 for a reply on the nomination. These were technical evaluators 632276 and 708671, and economic evaluator 507621.

[385] The standard deadline for evaluator 632276 for drawing up his expert opinion was
19 April 2012 and it was respected.

The standard deadline for evaluator 708671 for drawing up his expert opinion was 19 April 2012, but it was extended to 29 April 2012 because of two opinions returned to him for reworking.

The standard deadline for economic evaluator 507621 for drawing up his expert opinion was 16 April 2012 and it was respected.

Given that the conclusions of the technical expert opinions differed, a third expert opinion was commissioned in line with the above methodology.

The third expert opinion was commissioned from the second person on the reserve list - see the table on the selection of external evaluators by drawing lots. The reason for that was the first person on the reserved list had turned down his nomination for the project at issue. Refusals of nominations after lots are drawn in respect of a particular project are not irregular - the reasons could be leave, other work obligations, other expert opinions pending, or even illness. In short, it was the evaluator’s right to turn down the nomination and not evaluate the project. The above is also clear from the printscreen from a database of external evaluators in the ISOP system; this shows, for example, that the evaluator in question turned down his nomination for the evaluation of projects 687, 740, 758 and others.

The standard deadline for evaluator 802979 for drawing up his expert opinion was 14 June 2012 and it was extended to 20 June 2012.

Summary:

<table>
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<th>The applicant’s own evaluation:</th>
<th>Total number of points</th>
<th>Points rating</th>
<th>ESS* points</th>
<th>FRP points</th>
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<tr>
<td>Points awarded in the Evaluation report on the applicant’s economic situation</td>
<td>41</td>
<td>B+</td>
<td>Passed</td>
<td>Recommended</td>
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<tr>
<td>Expert opinion - external evaluator 1 not bold (technical)</td>
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<td>Recommended</td>
<td></td>
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<td>46</td>
<td>Recommended</td>
<td></td>
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<tr>
<td>Expert opinion - external evaluator 4 (economic)</td>
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<td>Recommended with reservation</td>
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<tr>
<td>Expert opinion - PM 5 (technical, average)</td>
<td>45.5</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

External evaluator - economic:
- the applicant is to submit proof of tentative interest expressed by potential buyers of the innovative product;
- the applicant is to submit a marketing strategy, describing how the company intends to succeed with the innovative product on the market.

The applicant submitted a marketing study and proof of tentative interest expressed by the companies Van Iperen and Ameropa AG.

Based on the selection criteria, a large enterprise could obtain a maximum of 81 points, with 45 points being the minimum eligibility threshold. A total of five expert opinions are in fact filed on the system. As stated before, the standard number of expert opinions for the Call, OP and project type at issue are two technical expert opinions and one economic
expert opinion. The system then creates one additional, automatically generated, expert opinion, which is the average of the scoring of the two technical expert opinions with the same conclusion.

[392] In this particular case, since the conclusion of one technical expert opinion was ‘Not recommended for funding’ and the other one ‘Recommended for funding’, a third expert opinion was commissioned. The situation as to the expert opinions is also documented by a printscreen from the ISOP information system (a list of documents in respect of the project), where the various types of expert opinions are specified.

Errors in the evaluation process

[393] In this connection, the MA of the Operational Programme ‘Entrepreneurship and Innovation for Competitiveness’ would re-iterate its reservation as to the competence to re-assess a research and development project in the field of chemistry and technology. As already stated above. The setting-up of the selection criteria and the substantive evaluation as such was carried out with sufficient expertise and in line with the applicable methodologies.

Criterion A3

[394] In this area, all three evaluators awarded the same number of points, i.e. two; a framework contract with the University of Chemistry and Technology (VŠCHT) concluded in 2008 is listed among the project documents in ISOP. In section 2.3 of the feasibility study, other contracts are mentioned, e.g. those valid as from 2010, 2001, etc. Therefore, the MA of the Operational Programme ‘Entrepreneurship and Innovation for Competitiveness’ deems this criterion to have been met.

Criterion A8

[395] As regards this criterion, two evaluators, who recommended the project for funding, awarded the same number of points, namely two. This criterion only refers to section 2.7 of the feasibility study and does not require further annexes. It is obvious from the feasibility study that the applicant carries out research and development projects and cooperates with a number of entities. It would have been almost impossible to carry out the activities mentioned if the applicant had not had any research and development capacity. The view that the applicant does not have its own research and development department is not a fact, but merely an unsubstantiated, subjective opinion. In the feasibility study, the applicant clearly states that ‘Within the organisational structure there is a development and quality management department, which forms the research base of Lovochemie a.s.’, and further gives a list of the research and development activities. Therefore, the MA of the Operational Programme ‘Entrepreneurship and Innovation for Competitiveness’ deems this criterion to have been met.

Criterion B1

[396] As already stated above, there are criteria that are evaluated from the applicant’s point of view. This criterion is one of them. Two of the evaluators recommending the project for funding awarded four and two points in respect of this criterion (therefore, in the expert opinion generated by the system the value given is three as it is the average - this value could not have been awarded by an evaluator as it is not defined in the selection criteria). The evaluator who did not recommend the project for funding awarded four points in respect of this criterion. In no way has it been clearly demonstrated that Lovochemie a.s. manufactures products identical to those manufactured by DUSLO. Moreover, it has also not been demonstrated that production at Lovochemie a.s. would not result in an expansion of its market share. Therefore, the MA of the Operational Programme ‘Entrepreneurship and
Innovation for Competitiveness' deems this criterion to have been met.

Criterion C1

[397] As already stated above, there are criteria that are evaluated from the applicant's point of view. This criterion is one of them. Two of the evaluators recommending the project for funding awarded three and three points in respect of this criterion, while the evaluator who did not recommend the project for funding awarded no less than six points. The project introduces a technically enhanced process to the applicant's company. Therefore, the MA of the Operational Programme 'Entrepreneurship and Innovation for Competitiveness' deems this criterion to have been met.

Criterion C2

[398] As already stated above, the information on who is the actual patent holder and with whom the contract was concluded is, in our opinion, irrelevant since the Call did not specify (or forbid) that it would not be possible to make use of the results of research and development or a transfer of technology within the group. All three evaluators involved in substantive evaluation awarded three points in respect of this criterion and, therefore, agreed that from the market's point of view this was a new process introduced in the Czech Republic. In no way has it been demonstrated that at the time of the evaluation the technological process at issue was already being used in the Czech Republic. Therefore, the MA of the Operational Programme 'Entrepreneurship and Innovation for Competitiveness' deems this criterion to have been met.

Criterion C3

[399] As already stated above, there are criteria that are evaluated from the applicant's point of view, such as the novelty of the resulting product from the point of view of the technical solution for the company. This criterion is one of them. The evaluators recommending the project for funding awarded six and three points in respect of this criterion. Therefore, the average generated by the system is 4.5 points. The feasibility study referred to by the selection criteria states, for example in section 3.3., that 'The new product LV GG will result from the separation of the insoluble residues from the mother melt; such a product has not been yet manufactured in this quality at Lovochemie, a.s. The innovative product LV AG will be manufactured using new technology for the granulation of fertilisers.' The information given in the study provides the details justifying the award of 3 and 6 points, respectively, in respect of the criterion at issue. We would again stress the above-described expert qualifications of the external evaluators, who all had adequate education, professional experience and training in the area of evaluation of projects under the Call at issue.

Therefore, we deem this criterion to have been met.

Criterion C4

[400] As already stated above, the information on who is the actual patent holder and with whom the contract was concluded is, in our opinion, irrelevant since the Call did not specify (or forbid) that it would not be possible to make use of the results of research and development or a transfer of technology within the group. All three evaluators involved in substantive evaluation awarded four points in respect of this criterion and, therefore, agreed that from the market's point of view this was a new product introduced in the Czech Republic. In no way has it been demonstrated that at the time of the evaluation, a product with such parameters was on offer on the market in the Czech Republic. Therefore, the MA of the Operational Programme 'Entrepreneurship and Innovation for Competitiveness' deems this criterion to have been met.
Criterion D1

[401] As already stated above in respect of criterion A3, a framework contract with the University of Chemistry and Technology (VŠCHT) concluded in 2008 is listed among the project documents in ISOP. In section 2.3 of the feasibility study, other contracts are mentioned, e.g. those valid as from 2010, 2001, etc.; the possession of a patent has also been demonstrated. As regards this criterion, the evaluators who recommended the project for funding awarded the same number of points, namely five. Therefore, the MA of the Operational Programme 'Entrepreneurship and Innovation for Competitiveness' deems this criterion to have been met.

We do not agree with the finding of insufficient audit trail related to external evaluators and deem it to be irrelevant in the light of the above facts. Moreover, we do not agree with the finding that the project at issue did not meet the binary criteria and should not have been supported. We would therefore ask that the finding be removed.

Errors in the evaluation process

[402] In this connection, the MA of the Operational Programme 'Entrepreneurship and Innovation for Competitiveness' would re-iterate its reservation as to the competence to re-assess a research and development project in the field of chemistry and technology. As already stated above. The setting-up of the selection criteria and the substantive evaluation as such was carried out with sufficient expertise and in line with the applicable methodologies.

In the light of the above facts, we do not agree with finding 20 and the recommendations suggested and ask that they be removed.

Conclusion of the Commission services:

The finding is maintained and further clarified as follows.

The Commission services have analysed the Member State’s reply and maintain their position that the project was not evaluated in line with the Evaluation Model, should not have been recommended for financing by the selection committee and, as a consequence, is not considered eligible for financing. The analysis of the Member State’s reply and additional argumentation supporting this conclusion are set out below.

In this regard, and to address concerns raised by the managing authority in respect of the auditors' competence in this area, the Commission services contacted two highly experienced external experts to re-perform the evaluation. One of these experts has a Doctorate degree in Technical Disciplines, is an associate university professor, has experience as a senior expert for the Commission and the European Parliament, over 20 years experience including 6 years of proposal assessment for the Commission Framework Programmes and is an expert in the fields of energy and the environment and methodology, research and development, innovation and impact assessment. The second expert has an MA in Applied social sciences, is an independent consultant in the areas of evaluation, agriculture, food, environment with more than 15 years experience (full EU coverage and selected non-EU countries), has worked in the public, academic and private sectors (both SMEs and corporate), has a strong background in evaluation methodologies, innovation and technology assessments and is an experienced evaluator and proposal developer for various funds, (e.g. European Regional Development Fund, European Agricultural Fund for Rural Development, Horizon 2020, EU Aid, International Agricultural Fund for Development, Green Climate Fund, Global Environment Facility, USAID).
Their conclusions confirm the Commission services position that the project should not have been selected and are incorporated in the analysis below.

1. Non-compliance with the binary criteria

1.1. Link of the project to R & D activities

REGIO auditors maintain their position that the binary criterion ‘Link of the project to R & D activities (use of R & D results, transfer of technology, patents, licences)’ has not been met and as a consequence the project has not met the eligibility criteria and should have been excluded.

In their reply, the Czech authorities state that:

- the criterion ‘development has been completed’ is deemed to have been demonstrated by presenting a patent’.
- The criterion regarding ‘the use of own research and development results, the research and development results created in cooperation or in the form of a transfer’ of technology is deemed to have been met on the basis of the contracts presented.

REGIO auditors note in this context that the patent presented by the applicant is owned by Duslo, a.s. and its use has not been licensed to the applicant. Instead, the applicant supports the alleged technology transfer by referring to a service contract concluded with VUCHT a.s. on 11 January 2012. However, the subject matter of this service contract is not a transfer of technology but rather an obligation of the service provider to prepare background documentation for the technological process of limestone lump decomposition by nitric acid (for the purpose of production of calcium nitrate FG). Thus, even if an internal technology transfer between AGROFERT group companies was accepted, this contract does not qualify as a technology transfer agreement compliant with the Call rules (see the second bullet point of section 1.1 of the Call for Applications). As the applicant did not present any other eligible agreement, he failed to meet this binary criterion.

1.2. Additional observations related to the binary criteria

1.2.1. Project has positive or neutral impact on the environment (criterion 3)

The applicant claims that the ‘positive impact of the project on the environment can be found in the reduction of the overall energy performance of the production, the reduction of pollution of waste water discharged by Lovochemie, a.s., and the reduction of dust on the side of the supplier of the current ground limestone’. However, this statement has not been supported by any eligible data. Regarding the energy performance in point 5.3 of the feasibility study there is only a declaration that ‘savings in energy intensity of production can be identified in the process of moving from ground limestone to decomposition of limestone lump by a chemical process. Each year around 50 tons of limestone are used within the plant. If limestone is to be decomposed using nitric acid, saving significant amounts will be saved for reduced electricity and natural gas’.

This statement does not provide any information about the value of energy savings. The correctly identified value should be given in kWh/year (or in GWh/year). The baselines, benchmarks and expected results are not given. A Life Cycle Analysis has not been carried out. Therefore, the positive or neutral impact on the environment has not been justified.

1.2.2. Economic and financial viability of the project - the market gap and the
feasibility of the chosen solution for its use (criterion 5.b)

The market gap was not identified properly as the applicant admitted that ‘Competitors in the production of calcium nitrate offer products of similar characteristics’ and the ‘method of production is broadly similar to that of the applicant’s competitors’. Moreover, as stated by the applicant, Hnojívá Duslo, s.r.o., another company within the AGROFERT group also produces the same products.

Non-compliance with the program conditions (Sectoral definitions)

REGIO auditors noted that in line with section 4.4 of the call for applications (Sectoral definitions) ‘projects whose outputs will be reflected in any of the following sectors are not supported: agriculture, forestry, fishery, aquaculture’

Given the fact that the outputs of the present projects will be reflected in the agricultural sector, the project did not meet the programme conditions and the project application should have been excluded from further evaluation as ineligible already at the admissibility stage.

2. Insufficient audit trail related to external evaluators selected for the substantive evaluation of a project

The Commission auditors note the clarifications provided on the involvement of the individual external evaluators used for evaluating the project application in question and acknowledge that adequate information related to the sequence of events for the recruitment of the three external evaluators has been provided. This part of the finding is therefore closed.

3. Errors in the evaluation process

Criterion A3 ‘Cooperation with R&D institutions or universities in the last three years’

Section 2.3 of the feasibility study lists cooperation with 8 entities (universities, research institutes and private undertakings). In order to provide evidence about the ‘cooperation with R&D institutions or universities in the last three years (supported by contracts)’, the applicant annexed a framework contract with VŠCHT concluded in 2008 and two service contracts concluded with the Czech University of Agriculture in Prague concluded in 2009.

The subject matter of the framework contract concluded with VŠCHT is not a joint research. The contract describes Lovochemie’s future plans to construct an R&D centre with a pilot line for production of granular fertilisers and the possibility to conclude specific agreements between the parties on future cooperation in R&D activities. However, such cooperation on contracts following this framework contract was not evidenced.

The subject matter of the two contracts concluded with the Czech University of Agriculture in Prague related to routine trials and testing and did not have the characteristics of research and development cooperation.

As none of the submitted agreements demonstrate cooperation in the field of research and development, REGIO auditors initially considered that no points should have been awarded for this criterion (instead of the two points awarded by the original evaluators). However, a more favourable assessment was given by independent external evaluator 2 contracted by the Commission who awarded 2 points under this criterion. This is the same number of points awarded by each of the two national evaluators. Therefore the evaluation of this criterion is not further questioned by the Commission services.

Criterion A8 ‘Own research and development department or innovation strategy of the company’
REGIO auditors maintain that the ‘Department of development and quality’ cannot be considered a research and development department. The applicant did not demonstrate that this department carries out any research and development activities. On the contrary, the 2012 Annual report of Lovochemie explicitly mentioned in Chapter 6 ‘Research’ that

‘the department of technical development was cancelled in 2012 and the research activities are dealt with centrally by AGROFERT Holding a.s.’

Given the fact that the applicant does not have a research and development department in its organisational structure and does not describe its innovation strategy, the Commission auditors maintain their position that no points should have been awarded for this criterion (instead of the 2 points awarded by all evaluators). This is supported by both of the independent expert evaluators contracted by the Commission, who both awarded 0 points under this criterion.

Criterion B1 ‘How is the project reacting to the market situation’

Concerning the Member State’s statement that ‘in no way has it been clearly demonstrated that Lovochemie a.s. manufactures products identical to those manufactured by DUSLO’, REGIO auditors refer to the last sentence of Section 3.4 of the Feasibility study, where the applicant stated that ‘samples are available at company Hnojivá Duslo, s.r.o. which is already producing these products’.

In relation to the market situation, as the applicant did not demonstrate the introduction of environmentally friendly products and processes, the project shows only a passive reaction to the market situation (maintaining the market share, replacement of ageing products, reducing the production costs). This conclusion is supported by the fact that similar products are already available on the market from other suppliers and also by the applicant’s own statement in Section 10.2 of the Feasibility study that

‘Competitors in the production of calcium nitrate offer products of similar characteristics and the method of production is broadly similar to that of the applicant’s competitors’.

Therefore, only 1 point should have been awarded for this criterion (instead of the 2 and 4 points awarded by the two original evaluators). This is supported by both of the independent expert evaluators contracted by the Commission, who both awarded 1 point under this criterion.

Criterion C1 ‘What is the novelty type of the process from the point of view of the technical solution’

In the criteria listed in section C of the evaluation sheet, the evaluator was asked to assess technical parameters of the project. However, this assessment is not limited to ‘the applicant’s point of view’ as suggested in the Member State’s reply. Instead, the evaluator is asked to compare all characteristics, parameters and ‘performance characteristics’ of the innovated solution which distinguish the project from the existing solution used by the applicant and his competitors.

Nevertheless, based on the more favourable assessment given by one of the two independent external evaluators contracted by the Commission services, who gave 3 points under this criterion, REGIO auditors accept that the three points awarded by the two national evaluators are justified and do not further question the points awarded under this criterion.

Criterion C2 ‘What is the novelty type of the process from the point of view of the market’

Based on the more favourable assessment given by the independent external evaluator 2, who gave 3 points under this criterion on the basis that there was no evidence of another producer
using the same process in the Czech Republic, REGIO auditors accept that from the point of view of the applicant, the project introduces a technically improved process and that the process is also new in the country. Therefore, the 3 points awarded for this criterion by the national evaluators is not further questioned by REGIO auditors.

Criterion C3 ‘What is the novelty type of the resulting product from the point of view of the technical solution’

As concerns the novelty of the product from the point of view of the technical solution, the project introduces only a modifications of an existing product (Calcium Nitrate fertiliser). The applicant did not demonstrate that the product will be technically improved as the effect of the modified fertilizer has not been described nor supported by adequate research results. Given the fact that the evaluation model does not envisage awarding points for modifications of an existing products, REGIO auditors initially considered that no points should have been awarded for this criterion (instead of the 3 and six points awarded by the two evaluators recommending the project for co-financing). Nevertheless, based on the more favourable assessment given by the independent external evaluator 2 contracted by the Commission services, REGIO auditors accept that up to 3 points could be awarded for this criterion as was the case for one of the two national evaluators. However, the 6 points awarded by the other national evaluator are not justified.

Criterion C4 ‘What is the novelty type of the resulting product from the point of view of the market’

As concerns the novelty of the product from the point of view of the market, the applicant confirmed in the Feasibility study that similar products are already on the market (one of them is produced by Hnojivá Duslo s.r.o. which is also part of the AGROFERT group). As the modified product is not new to the Czech market but only for the applicant, REGIO auditors initially considered that only one point should have been awarded for this criterion (instead of the 4 points awarded by the two national evaluators). Nevertheless, based on the more favourable assessment given by the independent external evaluator 2 contracted by the Commission services, who also gave 4 points under this criterion, REGIO auditors do not further question the original scoring under this criterion.

Criterion D1 ‘Exploitation of results of R&D in the project’

For criterion D1, the Member State’s reply refers to criterion A3 and to the framework contract with the University of Chemistry and Technology (VSCHT) concluded in 2008. The Member State further argues that

‘in section 2.3 of the feasibility study, other contracts are mentioned, e.g. those valid as from 2010, 2001, etc. and that the possession of a patent has also been demonstrated.’

In this regard and concerning criterion A3, REGIO auditors make reference to their position already set out above in in respect of this criterion (See heading Criterion A3 above).

As concerns the Member State’s argument that

‘the possession of a patent has also been demonstrated’,

REGIO auditors note that the applicant did not demonstrate possession of any rights related to a patent (i.e. ownership title or licence). In this context, REGIO auditors also refer to their assessment of Criterion A2 (‘Technology transfers taking place in the last 3 years in the form of exploitation of patent or purchase/sale of license’) and their conclusion that they did not identify any technology transfer, either referenced in the applicant’s feasibility study or provided in any of the submitted annexes.
As the applicant did not demonstrate the exploitation of R&D results in the project, no points should have been allocated for this criterion (instead of the 5 points awarded by both of the national evaluators). This is supported by both of the independent expert evaluators contracted by the Commission, who both awarded 0 points under this criterion.

Based on the above, REGIO auditors amend their initial finding and consider that the evaluation model was not followed for 4 selection criteria.

4. Additional observations related to errors in evaluation

The two independent expert re-evaluations carried out on behalf of the Commission services scored the evaluation as follows (the national evaluation is also included).

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Maximum points</th>
<th>National evaluation</th>
<th>EC independent expert evaluator 1</th>
<th>EC independent expert evaluator 2</th>
<th>Higher of Ev 1 &amp; Ev 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.1</td>
<td>3</td>
<td>0</td>
<td>0</td>
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<td>0</td>
</tr>
<tr>
<td>A.2</td>
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<td>0</td>
<td>0</td>
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<tr>
<td>A.3</td>
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<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>A.4</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
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<tr>
<td>A.5</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>A.6</td>
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<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>A.7</td>
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<td>0</td>
<td>0</td>
</tr>
<tr>
<td>A.8</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
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</tr>
<tr>
<td>Total A</td>
<td>17</td>
<td>10</td>
<td>6</td>
<td>6</td>
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</tr>
</tbody>
</table>

B. Need/relevance of project

<p>| | | | | | |</p>
<table>
<thead>
<tr>
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<tr>
<td>B.1</td>
<td>6</td>
<td>2</td>
<td>4</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>B.2</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
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<tr>
<td>Total B</td>
<td>9</td>
<td>5</td>
<td>7</td>
<td>4</td>
<td>4</td>
</tr>
</tbody>
</table>

C. Technical parameters of the innovation project

67 The minimum threshold for project approval is 45 in both cases (i.e. for SMEs and large enterprises)
| C.1 | 6   | 3   | 3   | 0   | 3   | 3   |
| C.2 | 6   | 3   | 3   | 1   | 3   | 3   |
| C.3 | 6   | 3   | 6   | 0   | 3   | 3   |
| C.4 | 8   | 4   | 4   | 1   | 4   | 4   |
| C.5 | 4   | 2   | 2   | 4   | 2   | 4   |
| C.6 | 2   | 1   | 2   | 2   | 0   | 2   |
| C.7 | 4   | 2   | 2   | 0   | 2   | 2   |
| C.8 | 4   | 2   | 2   | 0   | 2   | 2   |
| **Total C** | **40** | **20** | **24** | **8** | **19** | **23** |

### D. Contribution of the innovation project to the further development and competitiveness of the applicant

| D.1 | 5   | 5   | 5   | 0   | 0   | 0   |
| D.2 | 2   | 1   | 1   | 0   | 1   | 1   |
| D.3 | 2   | 0   | 0   | 0   | 0   | 0   |
| D.4 | 2   | 0   | 0   | 2   | 0   | 2   |
| D.5 | 2   | 2   | 2   | 0   | 2   | 2   |
| D.6 | 2   | 2   | 1   | 0   | 1   | 1   |
| **Total D** | **15** | **10** | **9** | **2** | **4** | **6** |
| **Total (Minimum threshold = 45)** | **81** | **45** | **46** | **16** | **33** | **39** |

Where the scores awarded by the two external evaluators differed, taking the more favourable scores under each affected criterion results in a revised maximum score of 39, which is still below the minimum selection threshold of 45.

The sub-criteria where the independent expert re-evaluation differs from the original evaluators (i.e. beyond the criteria already mentioned above namely A3, A8, B1,C1,C2, C3,C4 and D1) is A.2:

**Criterion A.2 – Delivery of technology transfers in the last 3 years in the form of a patent or purchase/sale of a licence/design**

The two national evaluators scored this criterion with 2 points and 0 points whereas both of the independent external evaluators contracted by the Commission gave 0 points as no relevant documentation was submitted to prove the technology transfer, equating to ‘no transfer’. The only transfer mentioned by the applicant concerned an internal transfer from VUCHT to Duslo, both of these companies being part of AGROFERT group. Therefore, no points should have been awarded under this criterion.

### Conclusion

For the reasons stated above, the Commission services maintain the position that the project did not comply with the binary criteria and with the programme conditions and should therefore not have been evaluated.

The Commission services also conclude that, even if the project passed the binary criteria (which is not the case here), based upon the results of the re-assessments carried out by the two independent experts contracted by the Commission services, who gave scores significantly below the minimum 45 point threshold required, the project should not have been selected. Indeed, even if the higher score of both external experts under each sub-
criterion is used by the Commission services, the total points would be 39, again below the 45 points threshold needed for selection.

Recommendation

The managing authority is requested to correct all related ineligible expenditure already declared for this operation under the operational programme.

Importance: Critical

Managing Authority OPPI 2007-2013 – Ministry of Industry and Trade

Deadline for implementation: 2 months
5.3. ESF Findings and actions to be taken / recommendations

5.3.1. Employment OP (CCI 2014CZ05M9OP001)

5.3.1.1. Findings on operations

Finding 21

Project No: CZ.03.1.52/0.0/0.0/16_043/0004636

Beneficiary: Synthesia, a.s.

Inadequate verification of the ownership structure and conflict of interests

The Commission services noted that the obligation for disclosing the ownership structure up to the level of the beneficial owner is applied for all calls for projects launched after 1/9/2016. Consequently, in the project application the applicant/beneficiary has to specify the beneficial owner(s) in the form of a declaration of honour. Moreover, the applicant/beneficiary is obliged to provide further supporting documents as regards their beneficial owners upon request of the MA. Finally, all changes in the ownership structure should be reported to the MA without delays.

The Call for project No 16 043 was published on 15/6/2016. At that time, no obligation for the applicant existed to submit its ownership structure with the application. However, as per Article 59(1) read in conjunction with Article 32(3) of the Financial Regulation 2012 the management and control system should avoid conflict of interests situations. Although no definition of conflict of interests is available for shared management, Article 57 of the Financial Regulation 2012 provides the elements and criteria under which a conflict of interests should be considered as present.

The grant agreement with the beneficiary (who is part of the AGROFERT group) was awarded on 1/3/2017. On 24/3/2017, the beneficiary informed the MA that there was a change of the ownership structure of the beneficiary as since 3/2/2017 the owners of the beneficiary Synthesia, a.s. became two trustees of the Trust Funds established by Mr Babiš.

The Commission services have the following observations:

- The project application was sent to the MA in August 2016, i.e. in the period when Mr Babiš served as Minister for Finance and Deputy Prime Minister for Economy and simultaneously was 100% sole shareholder of the AGROFERT group. Although the project application was thus sent before its entry into force of the modifications of the Conflict of Interests Act, the project was awarded after this entry into force. It is unclear to the Commission services which checks the Managing Authority applied to verify compliance of the grant request with the modified act and on the basis of which criteria it determined that the grant could be awarded.

As explained under the finding No 1, the beneficial owner in the case of trusts is the settlor, the trustee, the protector or the beneficiary. It means that Mr Babiš is also the beneficial owner of the Trust Funds. In order to avoid conflict of interests, the Commission services consider that this information should have been identified by the MA during the selection process. However, the Managing Authority did not inform us, to date, on the actual checks it performed to verify the structure of the Trust and its compliance with Czech national law.
Action to be taken/recommendation:

The MA is recommended to strengthen the review of the ownership structure up to the level of the ultimate beneficial owner, in particular in the case of trusts. Moreover, the MA needs to distinguish between the notion of business activity and the administration of a person’s assets when reviewing a conflict of interests, specifically Article 4(1) and (2) of the Czech Act No 159/2006 Coll. on conflict of interests.

Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[403] Call No 43 was published on 15 June 2016 and aid application No CZ.03.1.52/0.0/0.0/16_043/0004636 was submitted by the applicant Synthesia, a. s., on 29 August 2016. The proceedings for the granting of aid had been initiated before 9 February 2017 when the amendment to the Conflict of Interests Act amending Article 4c entered into force, and thus this provision does not apply to the period during which the proceedings for the granting of aid at issue were taking place. For more details see our arguments in respect of finding 1. Thus, even if the arguments put forward by the Czech Republic against finding 1 in Part B of the Audit were not accepted, the MA of the Employment OP did not infringe the prohibition laid down by Article 4c of the Conflict of Interests Act when it granted aid to the beneficiary Synthesia, a. s.

[404] Moreover, even the Commission auditors state, on page 56 [sic] in respect of finding 21, that the aid application for the project at issue had been submitted before the entry into force of the above amendment. Based on that, it cannot be established that Article 4c of the Conflict of Interests Act was infringed.

[405] As regards the recommendation, we would assure the Commission that ownership structures of aid applicants are examined pursuant to the rules in force. We would also refer to the reply of the MA of the Employment OP concerning audit finding 3 established by audit mission No EMPG314CZ0215, in which the MA undertook to take the auditors’ requirements into account at the earliest possible opportunity when revising the management documentation for the Employment OP. The revised documentation entered into force on 17 June 2019 and the procedures established have been respected since.

[406] As to the recommendation to verify the beneficial owner, in particular in the case of trusts, we would point out that in addition to examining the documents submitted by applicants, in the event of doubts the MA also checks the Registry of beneficial owners.

[407] We confirm that in the assessment of a conflict of interest a distinction is made between the notion of business activity and the administration of a person’s assets.

[408] Therefore, the measure is being fulfilled despite the Czech Republic’s disagreement with the finding.

Based on the above facts we disagree with the audit finding and request that it be removed.

Conclusion of the Commission services:

The finding is maintained and further clarified as follows.

Firstly, as already explained in detail under the finding No 1, the Commission services consider that both Article 4c and transitional provision in Article II(1) of Act 14/2017
amending the Conflict of Interests Act came into effect on 9 February 2017. Therefore, the project of the beneficiary Synthesia, a.s. was not awarded in breach of Article 4e of the Conflict of Interests Act. However, as also explained under the finding No 1, Mr Babiš was in breach of Article 4(1) of the Conflict of Interests Act.

Secondly, the Commission services acknowledge that the MA verifies, in the case of suspicion (in particular in the case of trusts), the information provided by the beneficiaries with the Register of information about the beneficial owners (Evidence skutečných majitelů). However, it is not clear what the criteria are for the MA to consider information provided by beneficiaries as ‘suspicious’.

The Commission services reiterate their position that from the date when both trust funds were established (i.e. 1 February 2017) the beneficial owner of the AGROFERT group is Mr Babiš (for details see finding No 1). Therefore, the information submitted by the beneficiary on 24 March 2017 in the above-mentioned project was incomplete, as was the data downloaded from the Register of information about the beneficial owners submitted by Czech authorities to the finding No 9. The Commission services maintain that Mr Babiš is the beneficial owner of the AB private trust I and II. (see finding No 1) despite the extracts from the Register of information about the beneficial owners submitted by the Czech authorities identifying the beneficial owners to be the trustees.

Thirdly, the Commission services take into account the modification of the internal rules of the MA since 17 June 2019.

Finally, the Commission services acknowledge that the recommendation is being implemented by the MA. However, the recommendation remains open until the MA includes in the internal rules of the MA a) the procedure how the ownership structure is verified in the case of trusts and what are the criteria for the MA to consider information provided by beneficiaries as ‘suspicious’ and b) the procedures how business activity and the administration of a person’s assets is distinguished when reviewing a conflict of interests by the MA. Moreover, c) the MA is requested to carry out an additional review of all projects awarded in the period from 9 February 2017 until 17 June 2019 in order to ensure that the Conflict of Interests Act was correctly followed.
Finding 22

**Project No:** CZ.03.1.52/0.0/0.0/16_043/0004636

**Beneficiary:** Synthesia, a.s.

The objective of the Call for projects No 03_16_043 published on 15/6/2016 was to provide trainings to employees of companies. Standard scales of unit costs for the training of employees were used. The selection of projects included the evaluation of objective information about the applicant, e.g. size of the business, business address and the types of trainings with a maximum number of 100 points to be awarded. As regards the evaluation of the size of the applicant, the Commission services noted that according to the award criteria a small enterprise receives 20 points, a medium enterprise 10 points and a large enterprise 0 points. This suggests that the intention of the MA was to provide EU support mainly to small and medium sized enterprises.

In case a project involved partners, the number of points awarded to an application was a simple average of points given to a particular participants (i.e. applicant and partners). This led to situations where large enterprises, acting as applicants, involved in their projects several small or medium sized partners in order to receive more points for ‘the size criterion’. However, the fact whether these partners participated substantially in the projects (i.e. whether the employees of these companies were trained) and what was the extent of their participation was not subject to the evaluation of the MA.

The project No CZ.03.1.52/0.0/0.0/16_043/0004636 of the beneficiary Synthesia, a.s. (a large enterprise) included a partner company [REDACTED] (a small enterprise). The estimated extent of the training for these two companies was as follows:

<table>
<thead>
<tr>
<th>Subject</th>
<th>Total value of the trainings to be provided to the employees</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Synthesia, a.s.</td>
<td>CZK 1,889,280 (€75,571)</td>
<td>99.47%</td>
</tr>
<tr>
<td></td>
<td>CZK 10,080 (€403)</td>
<td>0.53%</td>
</tr>
<tr>
<td>Total</td>
<td>CZK 1,899,360 (€75,974)</td>
<td></td>
</tr>
</tbody>
</table>

The project received 10 points for the criterion ‘size of the applicant’ for involving a small enterprise as a partner, even though this partner participated in the project only to a very small extent (0.53%). The auditors acknowledge that Synthesia a.s. would have received the grant even if the partner had not been involved.

The Commission services acknowledge that for future calls on training of employees the MA considered that projects of large enterprises will not be allowed to involve partners or partnerships will not be allowed at all. In fact, for the Call No 97 published on 15/3/2019 the MA decided to remove ‘the size criterion’ from the selection criteria altogether, i.e. applications involving small and medium enterprises are no longer favoured.

*Action to be taken / recommendation*

Recommendation

---

64 Exchange rate of 25 CZK/ EUR
The MA is recommended when designing the calls for projects that would give a priority to small and medium sized enterprises to ensure that the involvement of small and medium sized enterprises is substantial.

Importance: Important
Body responsible: MA
Deadline for implementation: 3 months

Position of the Member State:

Note: the paragraph numbering below corresponds to the numbering in the reply from the Czech authorities.

[409] The introduction of the criterion ‘Size of the applicant and the partner’ in Call No 43 was primarily aimed at favouring projects for which there is a higher need, i.e. projects involving SMEs.

[410] Pursuant to the rules of the Employment OP, partnerships are allowed in projects with unit costs focusing on further vocational training. Moreover, within a particular call for the submission of aid applications, the MA may either limit the number of partners or exclude partnerships completely.

[411] Under Call No 43, the minimum budget was set at CZK 500,000, mostly to ensure the effective administration of a call to which a large volume of funding was allocated. However, this threshold could have presented an obstacle in particular for SMEs, as in a number of cases organising training on such a scale might be impossible for some small or medium sized enterprises. That is why the MA decided to allow partnerships under that Call. This measure aimed at making support under the Employment OP available to a larger number of SMEs on the basis of partnerships with a financial contribution or even without any financial contribution.

[412] Following audit finding 5 established by audit mission No EMPG314CZ0215 and regarding the same issue under this Call, in response to the Commission recommendation the MA undertook to remove the criterion ‘Size of the applicant and the partner’ from the subsequent call, namely Call No 97, as pointed out in the MA’s reply.

[413] However, even this approach taken by the MA is contested by the Commission in finding 22, which claimed that by removing this criterion the desirable favouring of SMEs was also removed. In response to that the MA would point out that under Call No 97 SMEs are favoured by means of a new criterion for the project’s desirability, namely the criterion ‘Participants’ share in the total number of employees’. On the basis of this criterion applicants obtain more points if the persons receiving training represent a bigger share in the total number of the applicant’s and partners’ employees. Given the upper threshold of this aid measure (CZK 10 million), it is obvious that the highest number of points in respect of this criterion can be obtained only by SMEs. From the MA’s point of view it was equally crucial to support vocational training of employees in structurally affected regions confronted with a higher unemployment rate. Further vocational training of employees in those regions is of great importance, as the risk of losing a job owing to restructuring is higher there and the development of knowledge and skills and competences, in particular transferable ones, increases employability for the future. That is why in the evaluation process applicants from the Karlovy Vary Region, the Ústí nad Labem Region and the Moravian-Silesian Region supported under the RE:START programme were favoured in terms of points awarded.

[414] As regards the recommendation, we would point out that no more calls for training employees are planned under the Employment OP and the recommendation is therefore irrelevant for the OP. Nevertheless, the MA will consider putting the Commission
recommendation into practice when establishing calls in the subsequent OP for the 2021-2027 programming period.

In the light of the above facts, we would ask that the finding be closed since the corrective action has been taken or, to be more precise, no new measure is necessary as it is no longer relevant in the current programming period.

Conclusion of the Commission services:

The finding is maintained and further clarified as follows.

Firstly, as already stated in the final audit report from the audit No EMPG314CZ0215, the Commission services do not question the good intention of the MA to open the Call for projects No 43 to as many as possible small and medium companies. On the other hand, it is evident that in several instances this intention was misused by the large enterprises as applicants.

Secondly, as regards the new approach of prioritizing small and medium enterprises for the Call for projects No 97, the reply of the Czech authorities is inconsistent. On one hand, the Czech authorities state that project with the amount of CZK 500,000 as in Call for projects No 43 can be already an obstacle for small and medium enterprises. On the other hand, the Czech authorities state that for the Call for projects No 97 a new selection criterion ‘Participates’ share in the total number of employees’ aimed to prioritize small and medium enterprises (when the share equals or is higher than 63% leads to the maximum allocation of points – 25 points). However, no supporting information has been submitted by Czech authorities to prove this statement, although the evaluation of the Call for projects No 97 is already finalized. Moreover, it needs to be mentioned that for the project with the budget of CZK 500,000 (what is already according to the Czech authorities obstacle for the small and medium enterprises) it can support approximately 20 participants (taking into account the average costs CZK 25,000 per participant, which, according to the MA, the most efficient ratio). That would mean that only 40% of employees can be supported in the case of small enterprise with 50 persons (i.e. awarding of 16 out of 25 points) or only 8% of employees can be supported in the case of medium enterprise with 250 persons (i.e. awarding of 3.2 out of 25 points). This does not seem to support prioritization of small and medium enterprises. Therefore, the Commission services are concerned whether through this criterion were really prioritized small and medium enterprises.

Finally, based on information from media⁶⁹, the Commission services understand that a partner company did know about its involvement in the project. This only supports the suspicion of the Commission services that such ‘project partners’ were used as ‘strawpersons’ for large companies to receive more points during the selection process but without any role during the implementation of the project. The Commission services were informed that the MA requested the Police to investigate this case following the above-mentioned information appearing in the media. However, the Commission services understand that the Police closed this investigation⁷⁰.


Therefore, the recommendation remains open until the MA provides the Commission services with the following:

a) Analysis of the Call for projects No 97 and the impact of the criterion ‘Participants’ share in the total number of employees’ on the selection of the small and medium enterprises;

b) Justification provided by the Police why the investigation of the project No CZ.03.1.52/0.0/0.0/16_043/0004636 was discontinued; and

c) Clarification of the MA on how it verifies, during the management verifications, the real involvement of the project partners in the awarded projects and how the involvement lower than indicated in the project application will be treated by the MA.

Importance: Important
Body responsible: MA
Deadline for implementation: 3 months
6. **AUDIT CONCLUSIONS AND OPINION**

6.2. **AUDIT OBJECTIVES**

The objectives of the audit mission were:

*Audit objective 1*

In relation to the grants signed with companies of the AGROFERT group between June 2011 and July 2018, obtain reasonable assurance that the management and control systems covering the above-mentioned programmes before the entry into force of Financial Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union were compliant with the regulatory framework and functioned effectively regarding the allocation of EU funds, from the approval of the programmes to the implementation phase, focusing specifically to measures in place to avoid conflict of interests;

*Audit objective 2*

To verify, through the review of a representative sample of operations, that the MCS functioned effectively as to KR 2 - Adequate selection of operations as defined in the regulations applicable respectively for the 2007-2013 and 2014-2020 programming periods;

*Audit objective 3*

To verify, through the review of a representative sample of operations, that the MCS functioned effectively as to KR 4 - Adequate management verifications as defined in the regulations applicable respectively for the 2007-2013 and 2014-2020 programming periods;

*Audit objective 4*

To establish whether there is evidence of conflict of interest in the process of allocating EU funds to programmes or sectors that could favour operations introduced by companies of the AGROFERT group; and

*Audit objective 5*

To identify and assess changes in the structures, staffing and working procedure of the competent national authorities including the selection committees that might have influenced the attribution processes or the national controls and audits.

6.3. **MEMBER STATE OBSERVATIONS ON CHAPTER 6 OF THE DRAFT AUDIT REPORT**

[415] The conclusions set out on pages 59 and 60 of the Czech version of the draft audit report on the individual operational programmes cannot be inferred from the findings set out in Chapter 5. Each operational programme had or has its own management and control system and it cannot be concluded, on the basis of the findings made, that errors found in one operational programme could also occur under another operational programme and, in particular, from one programming period to the next. Even the Commission itself distinguishes between different programmes and not just between the funds that finance them. In spite of this, it sets out only one (common) error rate (18.48% according to the report sent) for all programmes, which runs counter not only to the actual situation but also to the rules on calculating the error rate. That conclusion does not take into account the principle

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72 See footnote 71.
of proportionality: the correction is not proportionate to the deficiencies identified in the draft report in relation to the overall allocation to the individual operational programmes. Even if we were to accept that that finding has no bearing and is merely an indicative one, we insist that it is contrary to every principle and in the context of the (draft) report it is insignificant, misleading and utterly irrelevant, and that its inclusion is baseless and without foundation.

[416] In line with the above comments on the various findings, whether of systemic nature or of an individual nature with a financial impact, it follows that the financial impact may be limited to the scope (see argumentation on the applicability pro rata temporis of Article 4c of the Conflict of Interests Act) of one project for OP EIC (see finding 1), one project for OP EI (see finding 19) and eight projects for OP EIC (see findings 12, 15, 17, 18 and 19), although even those findings are contested and dissenting opinions have been put forward.

[417] When assessing these results, we cannot agree with the assessment of the individual audit objectives and key requirements for each OP, in particular for the following reasons:

(a) for OP ENV (programming period 2007–2013) no finding was identified that would lead to an irregularity (financial correction) whether of a systemic nature or of a random nature in the sample selected. Thirteen projects were audited out of a population of 52 projects, which is sufficient to ensure that the management and control system worked and did not lead to irregularities. For this reason, we cannot agree with the assessment of objectives 1, 2 (KR 2), 3 (KR 4) and objective 4 in category 3 (see p. 61 of the Czech version of the draft audit report). A proper assessment in the light of the audit results would have resulted in an assessment in category 1. No finding is described in the findings for objective 4. In this context, we cannot accept the Commission’s request for the application of a financial correction of 18.48% either, as no deficiencies were identified in the sample for that programme and deficiencies were identified in other programmes that have a different management and control system. There is a certain inconsistency in the assessment as compared to the ESF assessment, where, for operational programmes where findings were not identified, there was no assessment of objectives 1 and 2, unlike the assessment for this programme.

(b) for OP ENV (programming period 2014–2020) no finding was identified that would lead to an irregularity (financial correction) whether of systemic nature or of a random nature in the sample selected. Two projects out of a population of 2 projects (i.e. a 100% sample) were audited, which is sufficient to give full assurance that the management and control system worked and did not lead to irregularities (Article 4c of the Conflict of Interests Act cannot be applied to either project, as Mr Babiš was not a member of the government at the time the grant was awarded). For this reason, we cannot agree with the assessment of objectives 1 and 4 in category 3 (see p. 61 of the Czech version of the draft audit report) or with the assessment of objectives 2 (KR 2) and 3 (KR 4) in category 2. A proper assessment in the light of the audit results would have resulted in an assessment in category 1. In this context, we cannot accept the Commission’s request for the application of a financial correction of 18.48% either, as no deficiencies were identified in the (100%) sample for that programme and deficiencies were identified in other programmes that have a different management and control system.

c) for the OPEI (programming period 2007–2013) one finding was identified that could lead to an irregularity (financial correction) of a random nature in the sample selected. Eleven projects were audited out of a population of 22 projects, which is sufficient to ensure that the management and control system worked and did not lead to systemic irregularities, but only to one random error. For this reason, we cannot
agree with the assessment of objectives 1, 2 (KR 2), 3 (KR 4) and objective 4 in category 3 (see p. 61 of the Czech version of the draft audit report). A proper assessment in the light of the audit results would have resulted in an assessment in category 1. No finding is described in the findings for objective 4. In this context, we cannot accept the Commission’s request for the application of a financial correction of 18.48 % either, as no systemic deficiencies were identified in that programme, but only one random error, from which one cannot draw the conclusion that it could have had an impact on the rest of the population, and further deficiencies were identified in other programmes that have a different management and control system. There is a certain inconsistency in the assessment as compared to the ESF assessment, where, for operational programmes where findings were not identified (see finding 1), there was no assessment of objectives 1 and 2, unlike the assessment for this programme.

d) for the OP EIC (2014–2020 programming period), we would point out that all projects subject to this audit took place within the period 2014–2017, at which time, in the context of the AA system audits carried out in 2017 and 2018, serious deficiencies were noted, which led to KR 2 and KR 4 being assessed in category 2 and 3, and in the context of the submission of the annual audit reports for the financial years 1 July 2016–30 June 2017 and 1 July 2017–30 June 2018 and the related audit opinions serious deficiencies were again identified in the assessment of KR 2 and KR 4, which led to a qualified opinion and the adoption of an additional extrapolated financial correction to reduce the residual risk to 2 %. The application of a further financial correction would constitute a duplicate ‘sanction’ for the operational programme in question. It is worth emphasising here that no project where deficiencies were identified by the EC auditors was included in the final accounts of the OP EIC approved by the EC.

[418] On the basis of the above, we also cannot agree with the qualified audit opinion with a significant impact, which is not substantiated by adequate findings. Moreover, individual opinions must be given for individual operational programmes, whereas the opinions for the ENV OP (2007–2013), ENV OP (2014–2020) and the OP EI (2007–2013) are not substantiated by findings with a financial impact or the adoption of corrective measures for these programmes.

[419] In the case of the OP EIC, the AA audit opinion from previous years is merely repeated.

[420] Finally, it is not clear how the EC auditors arrived at the assessment of the individual audit objectives, in particular Nos 2 and 3 (assessment of KR 2 and KR 4). According to Chapter 4, Approach, the EC auditors used the methodology set out in the Guidance for the Commission and Member States on a common methodology for the assessment of management and control systems in the Member States, but the assessment itself does not reflect this:

a) the individual assessment criteria for the different key requirements are not evaluated;

b) according to the findings in the draft report, factors that are not in keeping with the above Guideline — compliance with the Financial Regulation and the national Conflict of Interests Act — were incorporated in the assessment of KR 2. Although those laws may have an impact on the selection of individual operations (projects), taking into consideration the uniform assessment of the management and control systems of all operational programmes, they were not included in this assessment.

[421] The draft report proposes a projected random error rate of 18.48 %, which is unfounded and unverifiable as it is not clear how it has been calculated.
[422] In the light of the above, we ask you to revise the above-mentioned conclusions, in particular the category assessments of the individual audit objectives based on the final findings once this reply has been considered; to assess each operational programme and its error rate independently; to substantiate the calculation of the projected random error rate and to carry out a recalculation of it. Not least, we would like the opinion of the Commission auditors to take proper account of the results of the operation of the management and control system in the assessment of the OP EIC on the basis of the Annual Control Reports and Audit Opinions submitted for the last two financial years. At the same time, we request the Commission auditors to explain which amounts they used to calculate the error rate. It can be noted from the documents presented in the draft report that the calculation of the error rate is based on the amounts indicated in the legal documents relating to each individual project, or the respective share financed by EU funds (ERDF, CF), but the calculation of the error rate is supposed to be based on the amounts declared to the Commission, i.e. entered in the approved accounts (for the 2014–2020 programming period). We therefore request that any error rate be recalculated solely on the basis of the amounts declared to the Commission, i.e. entered in the approved accounts (for the 2014–2020 programming period).

**Observations on Chapter 6 — Audit conclusions and opinion, part 6.2.1 ERDF/CF Funds — assessment of key requirement 16 (adequate audits of operations)**

[423] Here we cannot accept the assessment of the Commission auditors that this key requirement should be assessed in category 2, as this assessment is not supported by any arguments, let alone findings set out in this draft, nor was any deficiency found in the course of the AA’s activities. For this reason, we strongly protest against the unfounded and factually inaccurate assessment in category 2. In this context, we would point out that only one project (ENV OP — 2014–2020) out of a population of 101 projects audited by the EC was subject to an audit of operations, whilst the AA dealt with any conflict of interest (as was also confirmed by the Commission auditors during the audit) and did not produce any findings. On the other hand, both in the context of the audits of operations and the system audit (which was not the subject of this audit), the AA reached the same conclusions (assessments) of the management and control system for OP EIC, which constitutes an adequate performance of the audit work carried out by the AA, i.e. the appropriate and factually sound assessment is category 1.

**We request that the category be reassessed to category 1.**

Observations on Chapter 6 — Audit conclusions and audit opinion, part 6.2.1 — ERDF/CF Funds A. Multiple random errors detected in the sample of operations audited indicating serious deficiencies in the functioning of the management and control systems

[424] Not even one project from the ENV OP 2007–2013 and the ENV OP 2014–2020 is concerned by the random errors detected in the sample of operations. For this reason we oppose the application of extrapolated corrections to those operational programmes. The list of random errors (Annex IIa) does not involve the ENV OP. The alleged high error rate of the OP EIC/OP EI projects should not be applied to ENV OP projects. At the same time, we cannot accept that a high error rate combined with the frequency and nature of the errors found points to the existence of serious deficiencies in the functioning of the management and control system of the ENV OP 2007–2013/2014–2020 and, on that basis, the assessment of the MCS of the ENV OP in category 3, not least because the auditors themselves state that at least the ENV OP 2007–2013 is not affected. The proposed financial correction of 18.48% cannot therefore be applied in this manner.

[425] In addition, for the ENV OP 2014–2020, potential conflicts of interest are currently being examined between a member of the government and a grant beneficiary only for 2 ENV OP projects (one of which, moreover, was initially on the reserve list). It is therefore unclear why the MCS was assessed in category 3.

[426] Furthermore, the AA’s audit work is not disputed from the point of view of the
Commission’s auditors, who must therefore also take into account the conclusions of the ACR on the ENV OP 2014–2020 and the opinions issued on the functioning of the MCS of the ENV OP 2014–2020. The fact that the national auditors did not put the MCS in category 3 for the ENV OP 2014–2020 must therefore be taken into consideration.

[427] Besides, no expenditure relating the sampled projects for the 2014–2020 programming period for which a financial correction is requested has yet been finally declared as eligible by the Member State in its accounts. With the exception of one payment application under the ENV OP 2014–2020 amounting to CZK 6.6 million (EUR 0.25 million), the EU share of the expenditure in question was either temporarily excluded from the accounts for the financial year 2017/2018 in accordance with Article 137(2) of the General Regulation or was not included in the payment application to the Commission. In the case of expenditure under the ENV OP in view of the 10 % retention applied by the Commission to payment claims, it can be assumed that no expenditure affected by the findings has so far been reimbursed from the EU budget. Thus, any financial corrections by the Member State in connection with the final audit conclusions can only be implemented such that the expenditure in question will not be declared by the Member State in its statement of expenditure. In addition, the project ‘Centre for the production of chemical specialities’, expenditure on which amounting to CZK 2.6 million (EUR 0.1 million) is the only expenditure included in the accounts for the financial year 2016/2017, is present in the non-audited part of the population. This is the only expenditure to which an extrapolated financial correction may be applied. With respect to the remaining projects in the population, the financial correction can be applied once they have been declared to the Commission.

We request that the text be corrected and that the calculation of the extrapolated financial correction of 18.48 % be revised.

Observations on Chapter 6 — Audit conclusions and audit opinion, part 6.2.1 — ERDF/CF Funds, B. Systemic errors relating to the breach of conflict of interests rules

[428] As stated by the Commission auditors, for the control activities prior to 9 February 2017 there was insufficient legal support for the MA/IIB to reject the applications submitted by entities subject to influence by a holder of public office. In relation to this matter, the EU Financial Regulation has been applicable in full only since its amended version entered into force on 2 August 2018.

[429] With regard to the period after 9 February 2017, at the time of the assessment the obligations under legislation in force were fulfilled in accordance with national legislation. Therefore a legal act was issued on the granting of aid for projects under the ENV OP to the applicants WOTAN FOREST and NAVOS, focused on the protection of the environment in the area of air protection and the elimination of environmental burdens, which is also in line with the objectives of support from ESIF resources and the interests of EU citizens.

Observations on Chapter 6 — Audit conclusions and opinion, part 6.2.1 ERDF/CF Funds C. Total corrections required

[430] Given that the Member State has already sent a final payment request to the Commission for the programmes of the 2007–2013 programming period, any financial corrections relating to the final audit conclusions can only be implemented by the Commission as part of the closure process of the programmes. The Commission’s auditors request a financial correction of 18.48 % on all operations for four OPs across programming periods, whereas deficiencies were detected only in two operational programmes with different management and control systems and a different legal basis. They also request the application of an 18.48 % financial correction (see point (a)) on operations that are to have a 100 % financial correction applied (see point (b)), which would mean that a financial correction of more than 100 % would be applied to some projects. We would point out that it is not possible to require the application of a financial correction of 18.48 % (see point (a)) to
operations to which a 100% individual financial correction is to be applied (see point (b)). In
the case of a 100% financial correction to an operation, no expenditure will de facto any
longer be declared to the Commission and therefore no further financial correction can be
implemented in respect of these operations. We consider that projects to which a 100%
individual correction is to be applied for systemic failures in accordance with Section B2
should be excluded from the population to which an extrapolated correction is applied.

Alternatively, the Commission auditors request verification of all 98 operations, despite
36 of them already having been verified and no deficiency with financial impact
on finding 1 (see in particular the reasoning on the applicability pro rata temporis of
Article 4c of the Conflict of Interests Act). This is entirely at odds with the results of the
audit.

The evaluation/assessment by the EC auditors in relation to the difference between
the conclusions for the projects under ENV OP managed by the Ministry of the Environment
and the business aid managed by the Ministry of Industry and Trade, in particular in relation
to timelines, is inadequate.

This must also be assessed in the light of the fact that part of the shortcomings
described in the report relate to the time of flat-rate corrections applied by the Czech Republic
to expenditure paid out to the beneficiaries up to 31 December 2012, to the not fully
operational MCS for the use of EU funds up until 2012. This gives rise to the application of a
doUBLE penalty in respect of the same shortcoming.

At the same time, as the Commission auditors consider the AA’s work not to be
influenced by the Finance Minister and in category 2, and the AA’s auditors carrying out the
system audits found no deficiencies in the MCS in the case of the ENV OP as regards the
dismantling of the ownership structure and the related assessment of the conflict of interest,
the assessment of the MCS for the ENV OP in category 3 must be rejected.

We request, in view of the actual results of the audit, and, following the incorporation of this
response, that this chapter be completely rewritten and that the steps to be taken by the
national authorities in this context be deleted. At the same time, the audit opinion must be
reassessed taking into account the individual objectives and programmes having regard to the
actual findings and evidence.

Observations on Chapter 6. — Audit conclusions and opinion, part 6.2.2 ESF

We cannot agree with the conclusion set out in the draft audit report with regard to
the OPE (programming period 2014–2020). One project out of a population of one project
(i.e. a 100% sample) was audited, which is sufficient to give full assurance that the
management and control system worked and did not lead to irregularities (Article 4c of the
Conflict of Interests Act cannot be applied to this project in view of the transitional provision
of that Act). For this reason, we cannot agree with the assessment of objectives 1, 2 and 4 in
category 3 (see p. 64). A proper assessment in the light of the audit results would have
resulted in an assessment in category 1. We should also stress that the assessment based on
finding No 22 differs significantly from the final evaluation of the management and control
system according to audit mission No EMPG314CZ0215, where finding No 22 was also
identified for the same call, which is not only inconsistent but, for the reasons given above, is
an unjustified and factually incorrect conclusion.

In the case of the OP HRE and OP PA, no error was identified and yet these OPs are also
classified under objective 4 as category 3.

For the above reasons, we request that the conclusions be reconsidered. We request, in view
of the actual results of the audit, and, following the incorporation of this response, that this
chapter be completely rewritten and that the steps to be taken by the national authorities in
At the same time, the audit opinion must be reassessed taking into account the individual objectives and programmes having regard to the actual findings and evidence.

6.3. AUDIT CONCLUSIONS, AUDIT OPINION AND CORRECTIVE ACTIONS

6.3.1. AUDIT CONCLUSIONS

The Member State’s comments made in paragraphs 349 to 369, in particular those concerning:

- the error rate calculation,
- its extrapolation for the 2007-2013 programmes and in particular for the Environment OP,
- the arguments concerning a possible duplicate correction for the 2014-2020 period and
- the conclusion on Key requirement 16 concerning the audit authority

are taken into account in the following sections.

6.3.2. ERDF/CF FUNDS

6.3.2.1. AUDIT WORK CARRIED OUT

Based on the work carried out on a representative sample of operations for which companies from the AGROFERT group were beneficiaries, as indicated in chapter 3, the auditors draw conclusions on the management and control systems in place to prevent conflict of interests.

For REGIO, the sample consisted of 36 operations selected from the 98 operations of the AGROFERT Group companies selected for co-financing by the ERDF/CF from 2012 to 2018. Such a large sample ensured high coverage of both managing authorities and both programming periods. The sample was also representative in respect of each of the four audited operational programmes for both programming periods, thereby enabling conclusions to be drawn in a differentiated manner for each of the four audited operational programmes and in particular for the Enterprise and Innovation for Competitiveness OP 2014-2020 where the audit identified a very high rate and frequency of errors. In fact, having carefully assessed the Member State’s reply, the Commission services have now drawn individual conclusions for each of the operational programmes audited, taking account of the fact that the audit results were different between the Environment OPs and the Enterprise and Innovation OPs in terms of both the frequency and rate of errors identified.

All 98 operations were assessed as regards compliance with Article 4c of Act No 253/2008 Coll., of 5 June 2008.

The sample of the 36 operations audited gave the following coverage:

<table>
<thead>
<tr>
<th>Prog. Period</th>
<th>MA</th>
<th>Value sample (EU contribution)</th>
<th>Value population (EU contribution)</th>
<th>%</th>
<th>Number of operations in sample</th>
<th>Number of operations in the population</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007-2013</td>
<td>MoIT</td>
<td>291.344.453,00</td>
<td>416.025.203,00</td>
<td>70%</td>
<td>11</td>
<td>22</td>
</tr>
</tbody>
</table>

225
<table>
<thead>
<tr>
<th>Year</th>
<th>Authority</th>
<th>Total 1</th>
<th>Total 2</th>
<th>Percentage</th>
<th>Operation</th>
<th>Count</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007-2013</td>
<td>MoE</td>
<td>684.273.007,00</td>
<td>799.839.868,45</td>
<td>86%</td>
<td>13</td>
<td>52</td>
<td>25%</td>
</tr>
<tr>
<td>2014-2020</td>
<td>MoIT</td>
<td>243.622.416,18</td>
<td>340.519.464,91</td>
<td>72%</td>
<td>10</td>
<td>22</td>
<td>45%</td>
</tr>
<tr>
<td>2014-2020</td>
<td>MoE</td>
<td>86.865.838,30</td>
<td>86.865.838,30</td>
<td>100%</td>
<td>2</td>
<td>2</td>
<td>100%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>1.306.105.714</td>
<td>1.643.250.374,7</td>
<td>79%</td>
<td>36</td>
<td>98</td>
<td>36%</td>
</tr>
<tr>
<td></td>
<td>EUR 50.624.252</td>
<td>EUR 63.691.875</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

6.3.2.2. AUDIT ANALYSIS

The following tables set out a summary of irregularities identified by the audit by:

- operational programme, programming period and Key Requirement
- operation, showing the type and frequency of the irregularities

Summary of irregularities by operational programme, programming period and Key Requirement

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Irregular operations due to Article 4c - COI (systemic issue for 2014-20)</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>Irregular operations due to selection issues (KR2) (systemic issue for 2014-20)</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>373</td>
<td>4</td>
</tr>
<tr>
<td>Irregularities not detected by management</td>
<td>0</td>
<td>0</td>
<td>674</td>
<td>6</td>
<td></td>
</tr>
</tbody>
</table>

73 Two of which are included in the 7 operations affected by COI.
74 Errors in 6 operations including selection errors, procurement errors in 5 contracts for one operation and double financing in 2 operations.
<table>
<thead>
<tr>
<th>Beneficiary</th>
<th>No. of project</th>
<th>Title of project</th>
<th>Total eligible cost CZK / EUR</th>
<th>EU contribution CZK/EUR</th>
<th>Article 4c Related irregularity</th>
<th>KR2 (select for irregularity)</th>
<th>KR4 Irregularity and detected by the mgt. verifications</th>
<th>Type of irregularity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lovochemie, a.s. Total 2007-2013</td>
<td>CZ.1.03/4.1. 00/14.00644</td>
<td>Komplexní projekt inovace výrobních postupů Lovochemie, a.s.</td>
<td>50,000,000 1,937,984</td>
<td>50,000,000 1,937,984</td>
<td>X</td>
<td>X</td>
<td>Incorrect selection and management verifications</td>
<td></td>
</tr>
<tr>
<td>Fekárska Zelená louka, a.s.</td>
<td>CZ.01.1020 09/01/2015 01 4/0000516</td>
<td>Inovační linka na výrobu toaletového chleba PENAM a.s.</td>
<td>400,000,000 15,503,876</td>
<td>100,000,000 3,875,989</td>
<td>X</td>
<td>X</td>
<td>Incorrect selection and Mgt verifications</td>
<td></td>
</tr>
<tr>
<td>Lovochemie, a.s.</td>
<td>CZ.01.1020 09/01/17_10 9/0011122</td>
<td>Inovace technologií výroby směsi pro přípravu stínových kojívek</td>
<td>200,000,000 1,937,984</td>
<td>50,000,000 1,937,984</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>Art 4c, Incorrect selection, Double financing</td>
</tr>
<tr>
<td>Ethanol Energy a.s.</td>
<td>CZ.01.3.1000 09/04/16_06 1/0011011</td>
<td>Technologie na zajištění energetické náročnosti výroby Ethanol Energy a.s.</td>
<td>240,139,679 9,307,391</td>
<td>72,039,203 2,792,217</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>Art 4c, Incorrect selection, Mgt verif. (double financing)</td>
</tr>
<tr>
<td>Cerea, a.s.</td>
<td>CZ.01.3.1000 09/03/16_06 1/0011179</td>
<td>Výměna sušáren vzníkajících potřeb za energeticky úsporné technologie</td>
<td>9,801,538 348,897</td>
<td>2,790,461 104,669</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>Art 4c, Procurement</td>
</tr>
<tr>
<td>Cerea, a.s.</td>
<td>CZ.01.3.1000 09/05/16_06 1/0011114</td>
<td>Výměna sušáren vzníkajících potřeb za energeticky úsporné technologie</td>
<td>9,325,900 361,434</td>
<td>2,797,500 108,430</td>
<td>X</td>
<td>X</td>
<td></td>
<td>Art 4c, Procurement</td>
</tr>
<tr>
<td>Cerea, a.s.</td>
<td>CZ.01.3.1000 09/05/16_06 1/0011122</td>
<td>Výměna sušáren vzníkajících potřeb za energeticky úsporné technologie</td>
<td>10,061,217 389,964</td>
<td>3,018,321 116,389</td>
<td>X</td>
<td>X</td>
<td></td>
<td>Art 4c, Procurement</td>
</tr>
<tr>
<td>Cerea, a.s.</td>
<td>CZ.01.3.1000 09/04/16_06 1/0011175</td>
<td>Výměna sušáren vzníkajících potřeb za energeticky úsporné technologie</td>
<td>8,808,043 341,397</td>
<td>2,642,142 102,419</td>
<td>X</td>
<td>X</td>
<td></td>
<td>Art 4c, Procurement</td>
</tr>
<tr>
<td>Cerea, a.s.</td>
<td>CZ.01.3.1000 09/04/16_06 1/0011185</td>
<td>Výměna sušáren vzníkajících potřeb za energeticky úsporné technologie</td>
<td>6,762,953 262,130</td>
<td>2,028,885 78,639</td>
<td>X</td>
<td>X</td>
<td></td>
<td>Art 4c, Procurement</td>
</tr>
<tr>
<td>Total 2014-2020</td>
<td></td>
<td></td>
<td>884,089,284 235,226,785</td>
<td>24,267,026 9,117,317</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
6.3.2.3. **AUDIT CONCLUSIONS**

The conclusions of the auditors are set out in the tables below, by operational programme, programming period and per audit objective. The reasons for all Category 3 assessments are also provided.


<table>
<thead>
<tr>
<th>Objective</th>
<th>Category&lt;sup&gt;75&lt;/sup&gt;</th>
<th>Reasons for Category 3 assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective 1 (MCS for COI)</td>
<td>3</td>
<td>Serious deficiencies in the design of the system to avoid conflict of interest (for 2007/2013) as regards Article 4(1) and, (for 2014/2020) in the design and functioning of the system to avoid conflict of interest as regards Articles 4(1) and 4c of the Czech law on conflicts of interests.</td>
</tr>
<tr>
<td>Objective 2 (KR 2)</td>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>Objective 3 (KR 4)</td>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>Objective 4 (Allocation of funds)</td>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>Objective 5 (Changes)</td>
<td>2</td>
<td>-</td>
</tr>
</tbody>
</table>

---

<sup>75</sup> **Category 1. Works well. No or only minor improvement(s) needed.** There are no deficiencies or only minor deficiencies found. These deficiencies have no, or minor impact on the functioning of the assessed key requirements / authorities / system.

**Category 2. Works, but some improvement(s) are needed.** Some deficiencies were found. These deficiencies have a moderate impact on the functioning of the assessed key requirements / authorities / system. Recommendations have been formulated for implementation by the audited body.

**Category 3. Works partially; substantial improvement(s) are needed.** Serious deficiencies were found that expose the Funds to irregularities. The impact on the effective functioning of the key requirements / authorities / system is significant.

**Category 4. Essentially does not work.** Numerous serious and/or wide-ranging deficiencies were found which expose the Funds to irregularities. The impact on the effective functioning of the assessed key requirements/ authorities/ system is significant – the assessed key requirements/ authorities/ system function poorly or do not function at all.
Enterprise and Innovation OP 2007-2013

<table>
<thead>
<tr>
<th>Objective</th>
<th>Category</th>
<th>Reasons for Category 3 assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective 1 (MCS for COI)</td>
<td>3</td>
<td>Serious deficiencies in the design of the system to avoid conflict of interest.</td>
</tr>
<tr>
<td>Objective 2 (KR 2)</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Objective 3 (KR 4)</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Objective 4 (Allocation of funds)</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Objective 5 (Changes)</td>
<td>2</td>
<td></td>
</tr>
</tbody>
</table>

Enterprise and Innovation for Competitiveness OP 2014-2020

<table>
<thead>
<tr>
<th>Objective</th>
<th>Category</th>
<th>Reasons for Category 3 or 4 assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective 1 (MCS for COI)</td>
<td>3</td>
<td>Serious deficiencies in the design and functioning of the system to avoid conflict of interest as evidenced by the 7 breaches of Article 4c of the Czech law on conflicts of interests.</td>
</tr>
<tr>
<td>Objective 2 (KR 2)</td>
<td>3</td>
<td>Serious deficiencies in the system to assess project applications as evidenced by the incorrect assessment of three operations.</td>
</tr>
<tr>
<td>Objective 3 (KR 4)</td>
<td>4</td>
<td>Due to the high error rate of 96.7% and the high frequency of errors identified in the sample audited. The impact on the effective functioning of the assessed key requirements/ authorities/ system is significant.</td>
</tr>
<tr>
<td>Objective 4 (Allocation of funds)</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Objective 5 (Changes)</td>
<td>2</td>
<td></td>
</tr>
</tbody>
</table>

In addition, concerning the adequacy of the audits of operations (KR16) this is assessed in category 1 (works well, no improvements are needed) in relation to the Agrofert group files selected within the scope of the present audit. The Commission auditors did not identify any evidence of undue influence over the audit authority during the period when Mr Babiš was Minister for Finance.
Based on the audit work carried out, the following conclusions can be drawn:

The audit on the area of conflict of interests:

- confirmed breaches of:
  - article 4(1) of the Czech conflict of interest law (Act No 159/2006) for the period before 9 February 2017.
  - articles 4(1) and 4c of the Czech conflict of interest law for the period after 9 February 2017.

In this respect reference is made to the conclusions under finding 1.

In view of those conclusions, the Commission services also conclude that:

- **for the period before 9 February 2017**, the Commission services conclude that Mr Babiš was engaged in business activity and the Czech authorities did not ensure that the management and control systems in place avoided situations of conflict of interests. In this regard, there was no evidence that any action has been taken at national level in respect of this non-compliance, which represents an additional deficiency in the management and control system. They thus did not comply with Article 32 (3) of Regulation 966/2012 and Article 4(1) of the Czech Act No 159/2006.

However, the Commission services understand that Czech national law on conflict of interest did not prohibit granting of public funds, including EU funds, to companies in which the public official was involved.

Therefore, due to the inherent difficulty in assessing the prejudice to the EU budget, no financial corrections are proposed by the Commission in respect of this breach of national rules or Article 32 (3) of Regulation 966/2012.

- **for the period after 9 February 2017**, identified 7 irregular operations from the 22 operations audited in the Enterprise and Innovation for Competitiveness OP 2014-2020 in respect of Article 4c of the national conflict of interests law.

For this period, the Commission services conclude that, in addition to the Czech authorities’ continued non-compliance with Article 32 (3) of Regulation 966/2012 and Article 4(1) of the Czech act, 7 grants awarded to the AGROFERT group companies after that date did not comply with Article 4c of the Act No 159/2006 and are therefore irregular.

In addition and separately from the issue of conflict of interests, the audit identified individual errors demonstrating the existence of serious deficiencies in the functioning of the management and control system for the Enterprise and Innovation for Competitiveness OP 2014-2020.

The **control testing** carried out during the audit:

- established a sample error rate (based on the grant amount and excluding the 7 irregular operations due to Article 4c) in the audited population in the Enterprise and Innovation for Competitiveness OP 2014-2020 of 96.7% (CZK 235,226,785 errors in sample of CZK 243,622,416 or EUR 9.11m errors in sample of EUR 9.44m). There was also a high frequency of errors (9 errors in the sample of 10 operations audited).
• identified serious deficiencies in the functioning of the management and control system regarding the selection of operations (KR2) and in the scope of management verifications (KR4) in the Enterprise and Innovation for Competitiveness OP 2014-2020 in relation to Agrofert.

• For the Environment OP for both the 2007-2013 and 2014-2020 programming periods, no such errors in the audited population or deficiencies in the management and control system for KR2 or KR4 were identified.

6.3.2.4. AUDIT OPINION


Qualified opinion: In our opinion, based on the audit work performed as indicated in chapter 3 of this report, the auditors have obtained reasonable assurance that the management and control systems, put in place at the level of the audited bodies, including the audit authority (see section 3 of the report) with regard the audit objectives 1 to 5 mentioned above, work effectively, except for:

• Audit objective 1, for the programming periods 2007-2013 and 2014-2020, for all MAs and IBs under for the Environment OP 2007-2013, Environment OP 2014-2020 and Enterprise and Innovation OP 2007-2013 where serious weaknesses were identified in the design of the system to avoid conflict of interest (for 2007/2013) and, (for 2014/2020) in the design and functioning of the system to avoid conflict of interest as regards Article 4c of the Czech law on conflicts of interests.

• Audit objective 2, for the programming period 2014-2020, for the MA and IBs under for Enterprise and Innovation for Competitiveness OP 2014-2020 where serious deficiencies were identified in the system to assess project applications.

where the qualification is significant (systems work partially, substantial improvements are needed - category 3).

Enterprise and Innovation for Competitiveness OP 2014-2020

Adverse Opinion: In our opinion, based on the audit work performed as indicated in chapter 3 of this report:

— the management and control system put in place does not function properly.

This adverse opinion is based on the following aspects:

• serious deficiencies identified in the functioning of the management and control system for Key Requirement 4 (adequate management verifications) in respect of Agrofert operations as evidenced by:
  o The 96.7% error rate in the sample of operations audited.
  o The high frequency of these errors (9 errors in the sample of 10 operations audited).
The fact that the management verifications did not identify these errors.

The above opinions are based on the evidence gathered in the context of our audit concerning the scope defined above.

6.3.2.5. **CORRECTIVE ACTIONS**

The national authorities are requested to take the following corrective actions:

- For the 2007-2013 programming period, to implement an individual financial correction in respect of the one irregular operation identified for the Enterprise and Innovation OP 2007-2013. The EU contribution amount for this operation was CZK 50,000,000.

- or the 2014-2020 programming period:
  - The managing authority for the Enterprise and Innovations for Competitiveness OP 2014-2020 is requested to cancel the public contribution to the 8 irregular operations identified by the audit.

See Annex II for details of these corrections / cancellations of the public contribution.

Due to the precautionary measures requested by the Commission services and implemented by the national authorities in relation to the issue of conflict of interests, no financial corrections are required in respect of the 8 irregular operations identified in the 2014-2020 programming period as either:

- no expenditure has been declared to the Commission to date for these operations, or

- any previously declared expenditure in respect of 4 of these operations was correctly excluded by the certifying authority from the 2017/2018 accounts under Article 137.2 of the CPR (i.e. for ongoing assessment of its legality and regularity). In this regard, the managing authority for the Enterprise and Innovations for Competitiveness OP 2014-2020 is requested to confirm that this expenditure will not be re-declared to the Commission.

- Due to the continuing breaches of articles 4(1) and 4c of the Czech conflict of interest law, the national authorities are requested to:
  - Make the necessary improvements to the management and control systems to ensure compliance with Article 59(1) and (4) read in conjunction with Article 32(3)c of the 2012 Financial Regulation and Article 63(1) and (4) read in conjunction with Article 36(3) of the Financial Regulation 2018, including the related management verifications.
  - verify all grants awarded for which a grant application was submitted on or after 9 February 2017 for both of the 2014-2020 operational programmes audited (i.e. the Enterprise and Innovation for Competitiveness OP and the Environment OP) to ensure that they were awarded in compliance with Article 4c of Act No 159/2006, as concerns possible conflict of interests situations that may have affected grants awarded to any beneficiary. Financial corrections and cancellation of
the related public contribution should be implemented for any irregular operations identified by this verification.

- advise of any actions taken or proposed to be taken for the non-compliance of Mr Babiš with these provisions.

The Commission services draw the attention of the national authorities to the need to consistently apply the applicable law in respect of the other 2014-2020 operational programmes and beneficiary companies in light of the identified breaches of Article 4(1) and 4c for the AGROFERT group or in any similar situations identified.

- For the Enterprise and Innovations for Competitiveness OP 2014-2020, improve the quality of the selection of operations process to ensure that only operations fulfilling both the binary selection criteria and the minimum points threshold are selected, including ensuring that evaluators have sufficient expertise.

- For the Enterprise and Innovations for Competitiveness OP 2014-2020, due to the high sample error rate (96.7%) and the high frequency of errors identified by the present audit, the managing authority is requested to re-verify the 12 operations not audited by the Commission services in the remaining part of the population of 22 Agrofert operations, in particular in relation to the type of irregularities identified by the present audit (irregular selection, double financing, irregular procurement).

6.3.3. EMPL AUDIT CONCLUSIONS, AUDIT OPINION AND CORRECTIVE ACTIONS

6.3.3.1. AUDIT CONCLUSIONS

The Member State’s comments made in paragraph 435, in particular those concerning:

- the conclusion on objectives 1, 2 and 4,
- the conclusion for the OP Human Resources and Employment and OP Prague – Adaptability,

are taken into account in the following sections.

As regards the argument that the audit conclusion from the current audit is not in line with the conclusions form the audit No EMPG314CZ0215, the Commission services would like to point out that during the audit No EMPG314CZ0215 (Early preventive system audit) the following projects from the Call for projects No 16_043 were audited:

1) CZ.03.1.52/0.0/0.0/16_043/0005259
2) CZ.03.1.52/0.0/0.0/16_043/0004438
3) CZ.03.1.52/0.0/0.0/16_043/0004501
4) CZ.03.1.52/0.0/0.0/16_043/0005498
5) CZ.03.1.52/0.0/0.0/16_043/0005230
6) CZ.03.1.52/0.0/0.0/16_043/0005101
7) CZ.03.1.52/0.0/0.0/16_043/0004152
8) CZ.03.1.52/0.0/0.0/16_043/0004449
9) CZ.03.1.52/0.0/0.0/16_043/0005530
As shown above, no project of the beneficiary Synthesia, a.s. (CZ.03.1.52/0.0/0.0/16_043/0004636) was present in the sample of the audit No EMPG314CZ0215. Therefore, the Commission auditors could not identify during the audit No EMPG314CZ0215 that Article 4(1) of the Conflict of Interests Act for the project implemented by the beneficiary Synthesia, a.s. was breached. Moreover, as clearly specified in the final audit report from audit No EMPG314CZ0215, the audit conclusion and opinion was provided based on the work carried out at a specific point in time without prejudice to further audit work from the Commission services. This is a reason why the audit conclusions and opinion differs between audit No EMPG314CZ0215 and audit No REGC414CZ0133.

6.3.3.2. AUDIT WORK CARRIED OUT

Based on the work carried out as indicated in chapter 3 of this report and without prejudice to further audit work from our services, the auditors draw conclusions on the operations for which companies from AGROFERT group were beneficiaries

For EMPL, the auditors audited all ESF operations (3 operations) granted to the AGROFERT group companies co-financed by the ESF from 2012 to 2018.

6.3.3.3. AUDIT CONCLUSIONS

The conclusions of the auditors are set out in the tables below, by operational programme, programming period and per audit objective. The reasons for all Category 3 assessments are also provided.

### OP Human Resources and Employment (2007-13)

<table>
<thead>
<tr>
<th>Objective</th>
<th>Category&lt;sup&gt;76&lt;/sup&gt;</th>
<th>Reasons for Category 3 assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective 1 (MCS for COI)</td>
<td>n/a&lt;sup&gt;*&lt;/sup&gt;</td>
<td>-</td>
</tr>
<tr>
<td>Objective 2 (KR 2)</td>
<td>n/a&lt;sup&gt;*&lt;/sup&gt;</td>
<td>-</td>
</tr>
<tr>
<td>Objective 3 (KR 4)</td>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>Objective 4 (Allocation of funds)</td>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>Objective 5 (Changes)</td>
<td>2</td>
<td>-</td>
</tr>
</tbody>
</table>

<sup>76</sup> Category 2. Works, but some improvement(s) are needed. Some deficiencies were found. These deficiencies have a moderate impact on the functioning of the assessed key requirements / authorities / system. Recommendations have been formulated for implementation by the audited body.
OP Prague – Adaptability (2007-13)

<table>
<thead>
<tr>
<th>Objective</th>
<th>Category(^77)</th>
<th>Reasons for Category 3 assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective 1 (MCS for COI)</td>
<td>n/a(^*)</td>
<td></td>
</tr>
<tr>
<td>Objective 2 (KR 2)</td>
<td>n/a(^*)</td>
<td></td>
</tr>
<tr>
<td>Objective 3 (KR 4)</td>
<td>n/a(^*)</td>
<td></td>
</tr>
<tr>
<td>Objective 4 (Allocation of funds)</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Objective 5 (Changes)</td>
<td>2</td>
<td></td>
</tr>
</tbody>
</table>

\(^*\) Both ESF projects audited for the programming period 2007-2013 were awarded before the participation of Mr Babiš in the Government. Moreover, the operation from the OP Prague – Adaptability was financially closed before the beneficiary was acquired by the AGROFERT group.

OP Employment (2014-20)

<table>
<thead>
<tr>
<th>Objective</th>
<th>Category(^78)</th>
<th>Reasons for Category 3 assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective 1 (MCS for COI)</td>
<td>3</td>
<td>Serious weaknesses in the design of the system to avoid conflict of interest (for 2014/2020) in the design and functioning of the system to avoid conflict of interest as regards Article 4(1) of the Conflict of Interests Act.</td>
</tr>
<tr>
<td>Objective 2 (KR 2)</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Objective 3 (KR 4)</td>
<td>n/a(^*)</td>
<td></td>
</tr>
<tr>
<td>Objective 4 (Allocation of funds)</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Objective 5 (Changes)</td>
<td>2</td>
<td></td>
</tr>
</tbody>
</table>

\(^*\) No expenditure declared to the Commission

Based on the audit work carried out, the following conclusions can be drawn:

The audit on the area of **conflict of interests**:

- confirmed breaches of:

\(^77\) Category 2. Works, but some improvement(s) are needed. Some deficiencies were found. These deficiencies have a moderate impact on the functioning of the assessed key requirements / authorities / system. Recommendations have been formulated for implementation by the audited body.

\(^78\) Category 3. Works partially; substantial improvement(s) are needed. Serious deficiencies were found that expose the Funds to irregularities. The impact on the effective functioning of the key requirements / authorities / system is significant.
• article 4(1) of the Czech conflict of interest law (Act No 159/2006) for the period before 9 February 2017.
• articles 4(1) and 4c of the Czech conflict of interest law for the period after 9 February 2017.

In this respect reference is made to the conclusions under finding 1.
In view of those conclusions, the Commission services also conclude that:

The Commission auditors did not identify any evidence of undue influence over the audit authority during the period when Mr Babiš was Minister for Finance.

The Commission services understand that the project of the beneficiary Synthesia, a.s. was cancelled.

6.3.3.4. AUDIT OPINION

Qualified opinion: Based on the work carried out as indicated in chapter 3 of this report, the auditors have obtained reasonable assurance that the management and control systems put in place at the level of the audited bodies (see section 3 of the report) with regard the audit objectives 1 to 5 mentioned above, work effectively, except for:

• Audit objective 1, for the programming period 2014-2020, for OP Employment where serious weaknesses were identified in the design of the system to avoid conflict of interest in the design and functioning of the system to avoid conflict of interest as regards Article 4(1) of the Conflict of Interests Act;

where the qualification is significant (systems work partially, substantial improvements are needed - category 3).

Due to the continuing breaches of articles 4(1) and 4c of the Conflict of Interests Act, the national authorities are requested to:

• Make the necessary improvements to the management and control systems to ensure compliance with Article 63(1) and (4) read in conjunction with Article 36(3) of the Financial Regulation 2018, including the related management verifications.

• Verify all grants awarded for which a grant application was submitted on or after 9 February 2017 for OP Employment to ensure that they were awarded in compliance with Article 4c of the Conflict of Interests Act, as concerns possible conflict of interests situations that may have affected grants awarded to any beneficiary. Financial corrections and cancellation of the related public contribution should be implemented for any irregular operations identified by this verification.

• Advise of any actions taken or proposed to be taken for the non-compliance of Mr Babiš with these provisions.

The Commission services draw the attention of the national authorities to the need to consistently apply the applicable law in respect of the other 2014-2020 operational programmes and beneficiary companies in light of the identified breaches of Article 4(1) and 4c of the Conflict of Interests Act for the AGROPERT group, or in any similar situations identified.
LIST OF ANNEXES

Annex I: Importance of recommendations
Annex II: Summary of proposed financial corrections
Annex III: List of systemic errors
Annex IV: List of projects selected for audit of Key Requirement 2
Annex V: List of projects selected for audit of Key Requirement 4
Annex VI: Opinion of the Czech Ministry of Justice
ANNEX I - IMPORTANCE OF RECOMMENDATIONS

System findings

Critical: Corrective action is needed to address a fundamental weakness in key controls, which puts in question the reliability of the whole or part of the management and control systems, and has led or may lead to widespread irregularities. There is a substantial risk to the reliability of (financial and other) reporting for the programme, the effectiveness and efficiency of the operations and activities and the compliance with national and EU regulations.

Very Important: Corrective action is needed to address a significant weakness in key controls, affecting the reliability of a significant part of the management and control systems, which has led or may lead to irregularities. There is a high risk to the reliability of (financial and other) reporting for parts of the programme, the effectiveness and efficiency of some of the operations and activities and/or the compliance with national and EU regulations.

Important: Corrective action is needed to address a weakness or deficiency in the management and control systems, which has a moderate impact at the programme level but which, combined with other weaknesses, may lead to irregularities. Improved controls would benefit the implementation of the programme and/or allow for greater effectiveness and/or efficiency.

Project findings

Critical: Corrective action is needed to address a serious irregularity (including irregularity of systemic nature) with high financial impact.

Very Important: Corrective action is needed to address an irregularity with medium financial impact.

Important: Corrective action is needed to address a weakness or an irregularity with no or limited (potential) financial impact.
<table>
<thead>
<tr>
<th>No. of project</th>
<th>Program</th>
<th>Beneficiary</th>
<th>Title of project</th>
<th>Signature date of grant decision</th>
<th>Total eligible cost</th>
<th>EU contribution</th>
<th>Grant to be utilised</th>
<th>Signature date of financial commitment (EU contribution)</th>
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<td>Title of project</td>
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<td>CZ.1.02/2.2/00.11.23004</td>
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<td>991 311 895,00</td>
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<td>Snížení emisí prachových látek</td>
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| **Programming period 2014-2020 - OP Životní prostředí** | | | | | |
| Pakšina Zelená louka, a.s. | OPřůk | CZ.01.1.02/9.00.015.014 | Inovace linky na vývoz kočka | 490 000,00 | 100 000,00 |
| Lovec, a.s. | OPřůk | CZ.01.1.02/9.00.015.014 | Inovace linky na vývoz kočka | 200 000,00 | 50 000,00 |
| Panem, a.s. | OPřůk | CZ.01.1.02/9.00.015.014 | Inovace linky na vývoz kočka | 8 000,00 | 2 000,00 |
| Kostelecká zahrada, a.s. | OPřůk | CZ.01.1.02/9.00.015.014 | Inovace linky na vývoz kočka | 19 055,00 | 5 718 630,00 |
| Ethanol Energy a.s. | OPřůk | CZ.01.1.02/9.00.015.014 | Inovace linky na vývoz kočka | 240 130 679,00 | 72 039 263,70 |
| CREA, a.s. | OPřůk | CZ.01.1.02/9.00.015.014 | Inovace linky na vývoz kočka | 10 081,00 | 3 018 321,00 |
| CREA, a.s. | OPřůk | CZ.01.1.02/9.00.015.014 | Inovace linky na vývoz kočka | 8 000,00 | 2 000,00 |
| CREA, a.s. | OPřůk | CZ.01.1.02/9.00.015.014 | Inovace linky na vývoz kočka | 6 702,00 | 2 023,665,00 |
| CREA, a.s. | OPřůk | CZ.01.1.02/9.00.015.014 | Inovace linky na vývoz kočka | 9 001,00 | 2 700,461,58 |
| CREA, a.s. | OPřůk | CZ.01.1.02/9.00.015.014 | Inovace linky na vývoz kočka | 9 325,00 | 2 977,000,00 |

<p>| Total | | | | | |
| Woltan Forest, a.s. | OPřůk | CZ.05.2.320/9.00.015.009 | Ekologizace energetického zdroje Woltan Forest, a.s. | 111 360,00 | 61 358 182,90 |
| NAVOS, a.s. | OPřůk | CZ.05.2.320/9.00.015.009 | Ekologizace energetického zdroje NAVOS v Kortově u Kýjev | 29 003,00 | 25 567,875,50 |
| Total | | | | | |
| 3 907 158 816,83 | 1 368 154 715,41 |</p>
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<th>Title of project</th>
<th>Total eligible Cost</th>
<th>EU contribution</th>
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<td></td>
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<td><strong>3,183,963,568.60</strong></td>
<td><strong>1,062,778,161.34</strong></td>
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Dear Minister,

In response to your request, I hereby send you this opinion of the Ministry of Justice on interpreting the conditions for applying the ban on provision of grants and investment incentives under Section 4c of Act No 159/2006 on conflicts of interests, as amended, focusing mainly on interpreting the term ‘controlling person’ and in relation to trust funds.

**General remarks on the ban under Section 4c of the Conflicts of Interests Act, interpretation of the term ‘controlling person’**

Under Section 4c of Act No 159/2006 on conflicts of interests, as amended (“Conflicts of Interests Act”), it is prohibited to provide a grant, under the legislation regulating budgetary rules [in this context the provisions in the footnote refer to Act No 218/2000 on budgetary rules and amending certain related acts (Budgetary Rules), as amended], or an investment incentive, under the legislation regulating investment incentives [in this context the provisions in the footnote refer to Act No 72/2000 on investment incentives and amending certain other acts (Investment Incentives Act), as amended], to a commercial enterprise in which a public official referred to in Section 2(1)(c) or a person controlled by a public official owns a share representing a holding of at least 25% in the commercial enterprise.

The term *commercial enterprise* is defined in Section 1(2) of Act No 90/2012 on commercial enterprises and cooperatives (Commercial Corporations Act), as amended (hereinafter “Commercial Corporations Act”)\(^1\), which includes under this term *public commercial enterprises*.

\(^1\) Article 40 of the Government Legislative Rules states that: “Legislation must be terminologically unified. At the same time, care should be taken to ensure conformity with the terminology used in related and connected
enterprises, limited partnerships, limited liability companies, joint stock companies, European companies and European Economic Interest Groupings. Commercial enterprises and cooperatives are thus grouped by Section 1(1) of the Commercial Corporations Act under the umbrella term of commercial corporation.

The ban laid down in Section 4c of the Conflicts of Interests Act applies in the case of commercial enterprises in which a public official referred to in Section 2(1)(c) or a person controlled by such an official owns a share representing a holding of at least 25%. A “public official” as set out in Section 2(1)(c) of the Conflicts of Interests Act, means a member of the Government or the head of another central administrative authority not headed by a member of the Government. Ministries and central administrative authorities are defined in Section 1 (Ministries) and Section 2 (Other central administrative authorities) of Act No 2/1969 on the establishment of the ministries and other central administrative authorities of the Czech Republic, as amended.

The terms controlled and controlling persons are defined in Section 74(1) of the Commercial Corporations Act. A “controlling person” is a person who can directly or indirectly exercise a decisive influence in a commercial corporation. A controlling person may be a legal person or a natural person, including the State or a public corporation, and even a “person” without legal personality, a “non-entity” (e.g. a trust fund). In the Commercial Corporations Act, a “controlled person” always means only a commercial corporation.

Control is in theory understood as a more qualified degree of influencing. While influencing may be random and one-off, control presupposes the possibility of the repeated exercise of influence. It is therefore sufficient just to have the possibility of exercising influence – for a person to qualify as a controlling person it is not necessary for that person actually to exercise their decisive influence. It should be added that this does not apply to a purely theoretical or potential possibility to exercise influence, but rather to a possibility that constitutes a real, substantiated, definite fact. If, however, a person exercises their decisive influence only from time to time, it will always be necessary first to examine whether it amounts to - random - influencing.

The Commercial Corporations Act uses the term decisive influence both in connection with the term ‘influencing’ (Section 71(1) and (4)), and in connection with the term ‘control’

 legislation of differing legal force. Where it is necessary to introduce a new legal term, the term must be defined in detail in the same legislation.” Therefore, if the legislation does not include a definition of a term, defining the intent and scope of the term for that legislation, the term must be assigned the meaning assigned to it by other legislation that does contain a definition – in this case the Commercial Corporations Act.

Section 74(1) defines the terms used in connection with control not only for the purposes of the Commercial Corporations Act, but also for the purposes of the specific legislation; it is a matter mainly of provisions that constitute definitions (Štěglová, I., Havel, B., Cílek, F., Kuhn, P., Šuk, P.: Commercial Corporations Act Commentary. 2nd edition. Prague: C. H. Beck, 2017, p. 214).

With reference to Section 2(2) of Act No 89/2012, the Civil Code, as amended, it can theoretically be concluded that a controlling or managing person may also be a trust fund or another non-entity, as long as the law gives it the ability to act, even by derivation. For more, see Štěglová, I., Havel, B., Cílek, F., Kuhn, P., Šuk, P., op. cit., p. 199.

For example Štěglová, I., Havel, B., Cílek, F., Kuhn, P., Šuk, P., op. cit., p. 214.


2
(Section 74(1). ‘Decisive influence’ in relation to ‘influencing’ means a decisive significant method of influencing actions or other behaviour of a commercial corporation, including influence exercised through another person or persons. The term decisive influence is understood similarly in cases of control: any quality of decisive influence in the case of control is by definition of a materially lower level than decisive and significant influence in the case of influencing, where such influence may also be exercised only once.6 Besides, it should be stated again, in the case of control, the mere possibility of exercising a decisive influence will suffice, but it must be a possibility in the form of a substantiated definite fact, not just a theoretical or potential possibility, and it does not have to be actually exercised (for the controlling person to qualify as such).

In both cases, in other words in the case influencing and in the case of control, it applies that influence does not have to be manifested only through legal actions within the meaning of Act No 89/2012, the Civil Code, as amended (hereinafter “Civil Code”), but also by other behaviour including the passive influence of the (controlling) person.7 Influence may also be exercised through another person or persons (i.e. indirectly). Direct influence may be in practice enabled, for example, through a direct share in voting rights, direct participation in decision-making processes within the framework of various types of shareholding, etc. Indirect may be, for example, influence exercised through a subsidiary or through an agreement on voting rights, etc.8

As stated above, under Section 74(1) of the Commercial Corporations Act, a ‘controlling person’ is a person who may directly or indirectly exercise a decisive influence in a commercial corporation. The existence of a possibility to exercise decisive influence on the actions or other behaviour of a commercial corporation, whether directly or indirectly, is thus the defining feature of a controlling person. For a final assessment as to the existence of control, it is necessary to examine whether

a) the actor has direct or indirect influence on the actions or other behaviour of a commercial corporation, regardless of whether or not he exercises that influence, and if there is a causal connection between the influence exercised and the actions or other behaviour of the commercial corporation, and also whether

b) such influence is decisive in relation to potential or actual specific actions or other behaviour of the commercial corporation.

7 DOLEŽIL, Tomáš. Section 74 (Control). In: LASÁK, Jan, Jarmila POKORNÁ, Zdeněk ČAP, Tomáš DOLEŽIL et al. Commercial Corporations Act : Commentary. Wolters Kluwer. ASPI_ID KO90_2012CZ. Available in the ASPI system; on this matter, it states that “The new Act does not expressly state that control can be implemented legally or factually. However, this still follows from the nature of the case. The legal fact which will usually establish control, is the participation of the controlling persons in the controlled person. The controlling person will then be capable (memorandum of association, majority of votes, etc.) of exercising a decisive influence through representation on the statutory or supervisory bodies. In the case of de facto influence the situation will be comparable to influencing and may follow from any significant circumstances (e.g. a person who is close to the majority shareholder), which means de facto the possibility of decisive influence (see the rules on conflict of interests).”
An assessment of the existence of control can be assisted by the assumptions set out in Section 75 of the Commercial Corporations Act, which this act links to the status of a specific person as a controlling person. The assumptions are nonetheless presented as rebuttable assumptions (in the words "it is considered"), and thus assumptions where the law admits evidence to the contrary. The conditions described in points (a) and (b) above can, from this perspective, be understood as a certain material corrective, without which it would be impossible to assess the occurrence of control reliably. In other words, the existence of a rebuttable assumption (as a term) does not provide sufficient grounds for drawing unambiguous conclusions as to the existence or identity of a controlling and controlled person, but any evidence to the contrary must always be presented by the person whose status as a controlling person is being assessed.

Apart from the rebuttable assumptions enumerated in Section 75 of the Commercial Corporations Act, this act also enshrines a normative instruction as to who is to be deemed a controlling and controlled person, in Section 74(3), where it specifies that managing persons pursuant to Section 79 and majority shareholders are always controlling persons. In the case of majority shareholders, the act nonetheless adds that the normative instruction shall not apply where the rebuttable assumptions in Section 75 specify otherwise. Additionally, the ultimate effect of the act is thus only to expand the list of rebuttable assumptions mentioned in Section 75 – majority shareholders cannot always and without further consideration be regarded as controlling persons. On the contrary, the only cases where it is not necessary to examine the applicability of the conditions for applying rebuttable assumptions, or whether the actor has direct or indirect influence on the actions or other behaviour of the commercial corporation and whether this influence is decisive in relation to specific actions or other behaviour of the commercial corporation, are cases where the actor is a managing person pursuant to Section 79 of the Commercial Corporations Act.

Trust funds and the ban under Section 4c of the Conflicts of Interests Act

Under Section 1448 of the Civil Code, a ‘trust fund’ means assets set apart from the ownership of the founder in such a way that the founder entrusts the administration of the assets to the trustee for a specific purpose by agreement or provision in the event of death and

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9 The provisions distinguish between the following assumptions: (i) It shall be considered that a ‘controlling person’ is a person who may appoint or dismiss most of the persons making up the statutory body of the commercial corporation or persons in a similar position or members of the supervisory body of a commercial corporation of which he is a shareholder, or who may force through appointments or dismissals. (ii) It shall be considered that a controlling person is a person who handles a share of voting rights representing at least 40% of all the votes in the commercial corporation, unless the same or a similar share is handled by another person or persons acting in concert. (iii) It shall be considered that persons acting in concert, who jointly handle a share in voting rights representing at least 40% of all the votes in a commercial corporation, are controlling persons, unless the same or a greater share is handled by another person or persons acting in concert. (iv) It shall be considered that a controlling person or persons shall also be a person who, alone or jointly, with persons acting in concert with them, obtains a share in the voting rights representing at least 30% of all votes in the commercial corporation and this share represented in the last 3 consecutive meetings of the supreme body of this person more than half of the voting rights of the persons present.


the trustee undertakes to hold and administer these assets. A **trust fund is not a legal person and it does not have legal personality. The establishment of a trust fund involves the establishment of separate and independent ownership of the allocated assets, and the trustee is obliged to accept the assets and administer them. The assets in a trust fund are not owned by the trustee or by the person who established the fund or by the persons who are to benefit from the trust fund.**

Section 1448(3) of the Civil Code thus expressly states that the trustee exercises ownership rights in respect of the assets in a fund in his own name but on behalf of the fund, and under Section 1456 of the Civil Code, the trustee has full authority to administer the assets in a trust fund. In public lists or other records, the trustee is recorded as the owner of the assets in the trust fund with the comment "trustee". In this context, it can be stated that the lawmakers entrusted a deciding role to trustees in relation to administered assets.

Regarding application of the ban mentioned in Section 4c of the Conflicts of Interests Act in relation to a trust fund, it should be stated that the **ban applies only to commercial enterprises in which a public official mentioned in Section 2(1)(c) of the Conflicts of Interests Act or a person controlled by such an official owns a share representing a holding of at least 25 % in the commercial enterprise.** The ban mentioned in Section 4c of the Conflicts of Interests Act therefore does not apply to trust funds in the sense that a trust fund cannot be regarded as a commercial enterprise which might be the beneficiary of grants or investment incentives under the special legislation, or as a controlled person, regardless of whether such a trust fund is subject to a decisive influence within the meaning of Section 74(1) of the Commercial Corporations Act and regardless of whether the assets assigned to the trust fund represent a share of at least 25 % (within the meaning of Section 4c of the Conflicts of Interests Act) in a commercial enterprise that is to be the beneficiary of such grants or investment incentives.

The conclusion that a trust fund is not a commercial enterprise is inescapable and requires no further comment. The fact that a trust fund cannot be regarded as a controlled person can then be considered, as stated above, on the basis of Section 74(1) of the Commercial Corporations Act. Whilst the cited provisions make it possible, in their meaning and purpose, to attribute to a trust fund, as a non-entity, the status of a controlling person (despite the fact that the act talks of a “person” in this context), in the case of a **controlled person, it expressly specifies that this term can only be applied to commercial corporations.** The terms ‘controlling’, ‘controlling persons’ and ‘controlled person’ are terms of a definitive nature and are defined by the Commercial Corporations Act not only for its purposes but also for the purposes of the special legislation. A similar conclusion follows from Article 40 of the Government Legislative Rules.

We should add that the terms ‘controlled person’ and ‘controlling person’ are not used in relation to trust funds by the Civil Code, which enshrines the concept of trust funds in Czech law. There is also no help to be had from the relevant provisions [Section 4(4)(c)] of Act No 253/2008 on certain measures against money laundering and the financing of terrorism, as amended (hereinafter “Act on Certain Measures Against Money Laundering and the Financing of Terrorism”), which, for the purposes of this Act, defines the concept of the

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actual owner of a trust fund, which is understood to mean a natural person who has de facto or de jure the power to exercise decisive influence in the trust fund directly or indirectly. The definition of 'actual owner' under the Act on Certain Measures Against Money Laundering and the Financing of Terrorism is in principle identical to the definition of 'controlling person' under the Commercial Corporations Act, but this fact does not, in itself, justify application of the given provisions by analogy and [under Section 4(4)(c) of the Act on Certain Measures Against Money Laundering and the Financing of Terrorism and Section 74(1) of the Commercial Corporations Act] the identification (or confusion) of the term 'actual owner' with the term 'controlling person' on the one hand and the terms 'legal person' and 'trust fund' or other legal arrangement without legal personality, with the term 'controlled person' on the other hand.

If we overlook the linguistic and systemic interpretation, it is also possible, when assessing whether the term 'controlled person', as the term is used in Section 4c of the Conflicts of Interests Act, can also apply to a trust fund, to take account of the lawmaker's intention, and thus to start from a subjective-teleological (historical) interpretation. In this specific case, the lawmaker's intention can be deduced from grounds for an amendment proposed (at the time) by the MP for Parliamentary Journal No 564 (7th electoral period, 2013 – 2017), which added the provisions of Section 4c to the Conflicts of Interests Act (hereinafter “amendment proposal”). The amendment proposal is justified in relation to the added provisions (Section 4a, Section 4b and Section 4c of the Conflicts of Interests Act) on the grounds that “The public officials mentioned in Section 2(1)(c) of the Conflicts of Interests Act ... should not participate in businesses as controlling persons.” In the reasoning it also states that “A mere ban on being a member of the statutory bodies of a commercial legal person [nb: clearly meaning a legal person or a commercial enterprise within the meaning of the added provisions] as mentioned in Section 4(1)(b), completely fails the test here, as it neglects the real influence of the controlling person in the commercial enterprise.” The author of the reasoning adds that “If a conflict of interests arises for a member of the Government who is at the same time exercising a decisive influence [in] a commercial legal person, it cannot suffice for this conflict of interests only to be notified under the law.”.

The passage cited from the reasoning indicates that the ban specified in Section 4c of the Conflicts of Interests Act was not intended only for cases when a public official mentioned in

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12 According to Section 4(1)(c) points 1 to 3 of the Act on Certain Measures Against Money Laundering and the Financing of Terrorism consider that (taking the form of the rebuttable assumptions enshrined in Section 75 of the Commercial Corporations Act), that the real owner of a trust fund is the natural person (or the real owner of the legal person) who is in the position of founder, trustee or grantor. However, this always applies only with fulfilment of the condition that the natural person has de facto or de jure the possibility to exercise decisive influence in the trust fund directly or indirectly.

13 Tvríčová, J., Vavroušková, A. The Act on Certain Measures Against Money Laundering and the Financing of Terrorism. 2nd edition. Prague: C. H. Beck, 2018, expressly states in relation to this on page 19 that an actual owner is essentially a “controlling person, as described in Section 74 of the Commercial Corporations Act (which does not, however, specify a limit where such persons are identified based on numbers of voting rights, and therefore this term cannot be used for the Act on Certain Measures Against Money Laundering and the Financing of Terrorism).” Clearly, the only deviation consists in the fact that a real owner can only be a natural person, according to the Act on Certain Measures Against Money Laundering and the Financing of Terrorism, whilst a “controlling person” pursuant to the Commercial Corporations Act may be a natural or legal person, or even a non-entity, and also in the formulation of the individual rebuttable assumptions establishing the status of the controlling person (actual owner).

Section 2(1)(c) of the Conflicts of Interests Act or a person controlled by such an official owns a share representing a holding of at least 25% in a commercial enterprise which is to be the beneficiary of grants or investment incentives under the relevant legislation, but also to cases when a public official mentioned in Section 2(1)(c) of the Conflicts of Interests Act exercises a decisive influence over such a legal person and is thus a ‘controlling person’ within the meaning of Section 74(1) of the Commercial Corporations Act (regardless of whether the influence is exercised directly or indirectly). This intention, however, is not, in our opinion, expressed unambiguously in the amendment proposal and moreover, is not supported at all in the wording of the provision concerned. It has been previously judged that if the lawmaker does not express his intention in a normative sentence or does not express it clearly, the benefit of the doubt must go to the addressee of the measure. Interpretation based on the intention of a past lawmaker can thus take precedence over a linguistic interpretation or a systemic interpretation only when there is no doubt as to the clarity and exclusiveness of the meaning and purpose of the law and where the literal wording of the provision shows signs of ambiguity or incomprehensibility. This does not, however, apply in the case in hand. In our opinion, an interpretive conclusion accenting the intention of the lawmaker would not be sustainable.

With regard to the foregoing, we have concluded that, in the case of trust funds, clearly the only situation in which application of the ban laid down in Section 4(e) of the Conflicts of Interests Act can be considered is a situation where, via a trust fund (and thus indirectly), a decisive influence is exercised over a commercial corporation (the controlled person) which itself owns a share representing a holding of at least 25% in a commercial enterprise that is to receive grants or investment incentives under the special legislation. As stated earlier, in an environment of control, influence may be exercised directly or indirectly, and thus even via another person or a non-entity (a trust fund, which may itself may be the controlling person — for more, see above). However, before reaching a final conclusion on control, it is always necessary to examine, at all levels of control (if influence is being exercised indirectly), whether this influence is decisive in relation to the actions or other behaviour of the controlled person and is directly connected to it; the mere possibility of exercising such decisive influence will also suffice.

Conclusion

It can be concluded that entities which decide on the provision of grants under the legislation regulating budgetary rules, or decide on investment incentives under the legislation regulating investment incentives must, in addition to the other particulars and conditions for the provision of grants or investment incentives arising from the aforementioned and other special legislation, also examine whether the grants or investment incentives are to be provided to a commercial enterprise in which a public official mentioned in Section 2(1)(c) of the Conflicts of Interests Act, and thus a member of the Government or head of another central administrative authority not headed by a member of the Government, or a person controlled by such a public official, owns a share representing a holding of at least 25% in the commercial enterprise.

15 For example the resolution of the extended bench of the Supreme Administrative Court of 20. 11. 2012, ref. 1 As 89/2010-119.

16 For example, decision of the Supreme Administrative Court of 1. 6. 2011, ref. 1 As 6/2011 – 347 (Case before the court: possibility of a regional court to deviate from the case law of the Supreme Administrative Court).
When assessing the existence of control, the rebuttable assumptions listed in Section 75 of the Commercial Corporations Act can be applied. The key issue, however, for a final assessment of the existence of control will always be whether the controlling person can, in the controlled person, directly or indirectly exercise a real and decisive influence on the actions or other behaviour of that person. Evidence to the contrary should always be brought by the individual whose status as a controlling person is being assessed.

Trust funds cannot be understood either as a commercial enterprise that is to be the beneficiary of grants or investment incentives under the special legislation, or as a controlled person within the meaning of Section 4c of the Conflicts of Interests Act, and the ban specified I the provision referred to therefore does not apply. A trust fund may nonetheless play a role as a non-entity through which a decisive influence is exercised over a commercial corporation (the controlled person) which owns a share representing a holding of at least 25 % in a commercial enterprise which is a potential beneficiary of grants or investment incentives under the special legislation; where this is the case, it would also be appropriate to apply Section 4c of the Conflicts of Interests Act. As trust funds do not have legal personality and trustees have the deciding role in relation to administration of the assets in funds, it can be concluded that the decisive influence would have to be exercised through the trustee.

We would like to point out that the Ministry of Justice is authorised by law to make binding interpretations of legislation, even in cases where it acts in the role of sponsor in relation to the legislation. Only the courts or other bodies applying the law in practice are allowed to make binding interpretations of legislation within the framework of their legal powers. For this reason, the above opinion is only of an advisory nature.

Greetings

JUDr. Jan Kněžínek, Ph.D.
Minister of Justice

Ing. Klára Dostálová
Minister for Local Development
Ministry for Local Development of the Czech Republic
Staroměstské náměstí 6
110 15 Prague 1
IDDS: 26iaava